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REAL ESTATE SETTLEMENT PROCEDURES ACT [RESPA]

HEARING

BEFORE THE

SUBCOMMITTEE ON
HOUSING AND URBAN AFFAIRS

OF THE

COMMITTEE ON
BANKING, HOUSING, AND URBAN AFFAIRS
UNITED STATES SENATE

ONE HUNDRED FIRST CONGRESS

SECOND SESSION

ON

HOW TO PROVIDE SUFFICIENT CONSUMER PROTECTION AGAINST ABUSES IN MORTGAGE LENDING WHILE PERMITTING INNOVATIONS IN SETTLEMENT SERVICES THAT WILL BENEFIT HOME BUYERS

SEPTEMBER 19, 1990

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REAL ESTATE SETTLEMENT PROCEDURES ACT [RESPA]

WEDNESDAY, SEPTEMBER 19, 1990

U.S. Senate,
Committee on Banking, Housing, and Urban Affairs,
Subcommittee on Housing and Urban Affairs,
Washington, DC.

The subcommittee met at 9:10 a.m., in room SD-538 of the Dirksen Senate Office Building, Senator Alan Cranston presiding.

Present: Senators Cranston, and D'Amato.

OPENING STATEMENT OF SENATOR CRANSTON

Senator Cranston. Our session will please come to order.

I welcome all of you. We are having this round table hearing on the effectiveness of the Real Estate Settlement Procedures Act.

I appreciate your willingness to accommodate a last-minute change in the meeting schedule which was made necessary by urgent Senate business relating to the gulf situation.

The issue before us this morning is how to provide sufficient consumer protection against abuses in mortgage lending while permitting innovations in settlement services that will benefit home buyers.

In 1974, Congress enacted the Real Estate Settlement Practices Act, or RESPA, to regulate certain lending practices for closing and settlement procedures and to protect consumers from unnecessary costs and unfair practices when they buy a home.

Congress did not intend to preclude legitimate developments in business practices. Intense debate has grown in recent months over the development of computerized loan origination systems called CLO's.

Many believe that the CLO's are a technological breakthrough that will benefit consumers.

Many others believe that they are a sophisticated form of the old kickback scheme which RESPA was designed to eliminate.

The Department of Housing and Urban Development has clear responsibility to provide adequate public hearings and to clarify questions of possible RESPA violations.

This is a very important issue. HUD must do a careful evaluation of the facts and make some tough decisions.

Officials in the Reagan administration tended to believe that HUD should keep their hands off and let the market determine lender referral fee practices.

I disagree, and history has shown that if Government does not provide responsible oversight, consumers too often become the victims of deceptive referral pay schemes and other factors that drive up the cost of buying a home.

I believe that it is HUD's duty to enforce RESPA and to prescribe regulatory remedies where necessary.

I suspect that HUD now has all the statutory authority it needs to resolve questions that have been raised regarding CLO's.

It is possible of course that the concerns raised by CLOS ultimately will require legislation.

That is one of the questions before the subcommittee this morning. It is promising that Finance, after more than a 2-year wait, HUD has just announced a proposal for dealing with CLO's. As I understand it, HUD has come to believe that CLO's do not violate RESPA.

HUD stated that "technology has reached the point where loan originations and information can be provided by the real estate brokers efficiently and economically" and that it is in the interest of the home buyers to use the service.

HUD has concluded that CLO's will provide consumers with better information and greater choice when the realtors who use CLO's are required to display loans from competing lenders.

HUD believes that consumers will be protected from collusion if a realtor is required, first, to tell home buyers that the realtor receives fees for the CLO services; and, second, to inform home buyers about other lenders who are not part of the CLO's system and who may offer more reasonable terms.

HUD has also expressed concern that the real estate settlement process is becoming increasingly complex and that new opportunities for abuse have emerged.

Those are the key issues before our witnesses this morning. One question is whether HUD's proposal would provide adequate protection to ensure against potential abuses in the changing world of settlement services.

The second question is whether a routine disclosure of the possibility of cheaper settlement services is sufficient information for consumers to make an informed decision.

The third question is whether the HUD proposal provides effective regulation of CLO's.

Today we will hear from leading experts from among mortgage lenders, real estate brokers, and consumer groups. Each of our witnesses this morning is well qualified to discuss the merits of the HUD proposal and to provide suggestions for refinements. I look forward to this discussion.

Before we begin, I want to comment on the format of today's hearing.

This is a roundtable hearing. I find this approach produces a more informative discussion of ideas among witnesses and the subcommittee.

The roundtable will be most useful if witnesses share differences of opinion as well as areas of agreement. Please feel free to enter the discussion at any time you want to elaborate upon or disagree with something that is said.

That way, we on the subcommittee can learn the most. Our time is short, and we have much ground to cover. So I ask each of you to be brief in your opening comments so that everyone will have a chance to participate.

Without further delay, let us turn to the discussion.

Who would like to start?

STATEMENT OF FRANCIS A. KEATING, GENERAL COUNSEL, DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT, WASHINGTON, DC

Mr. KEATING. Mr. Chairman, perhaps it would be helpful on Secretary Kemp's behalf if I outlined briefly just what it is that HUD proposes so that——

Senator CRANSTON. May I suggest that we try, each of us, to say what we have to say in three minutes.

Mr. KEATING. I think everybody agrees that what we did was sound, so I think it will probably only take a few minutes to discuss it. [Laughter.]

But we found, Mr. Chairman, that because of the pressures to investigate alleged criminal violations of the statutes and because of the *Graham Mortgage* case and the 6th Circuit Court opinion that estopped us from doing that, we had to fix that.

We had to address the need to revitalize criminal investigations and to permit them to go forward.

We had to revitalize what the Congress expected us to do when it passed the RESPA amendments in the mid-1980's under the "controlled business arrangements," the controlled business relationships.

We also had to examine whether or not the CLO system, as you indicated in your opening statement, Mr. Chairman, was consistent with the mandate of the Congress and consistent with Secretary Kemp's desires to increase competition and create the encouragement of technology and also protect consumers.

Secretary Kemp concluded that that could be done, provided systems like the Citicorp system were open to competition and provided for a 2-year phase-in in this final rule which we are proposing, yesterday, to issue.

We expect to have competition within those systems. We expect to limit the fee that a realtor can charge for that service.

We expect to, as you indicated, provide for full disclosure so that the realtor in this particular circumstance would tell the borrower three things: (a) that this is not the only loan available—as a matter of fact, this may be higher than you could get on the outside—and that I am being paid a fee to suggest to you that you utilize my services.

We also expect to limit the payment from the borrower to the realtor, not from the mortgagee lender down.

Also, the question of escrow accounts has come up because that is something that seven State Attorneys General have contended is a sore point with consumers.

This is a part of our responsibility under the statute to examine and we are, effective immediately, securing the services of a competent outside analyst to examine the issue and determine whether in fact what is being done in these settlement services and the lending industry is consistent with the mandate of the Congress.

We intend to expand the office that we have overseeing the RESPA statute at HUD, and in fact we intend to be fully consistent with what the Congress expects and to be in the business of regulating the statute and enforcing the statute as, for the last number of years, we have not been doing.

Senator **Cranston**. I hope to pose a few questions to the panel, and I appreciate that tight summary of the situation.

To what extent does HUD's proposal address the problem of CLO's and potential RESPA violations?

What are its strengths?

What are its weaknesses?

How effective will the HUD proposal be in ensuring disclosure of lenders and encouraging access to lenders who did not subscribe to Computerized Loan Origination Systems?

And how much of a difference would it make if borrowers paid realtors for the service rather than to borrowers directly?

STATEMENT OF LEONARD DRUGER, VICE CHAIRMAN, CITICORP MORTGAGE INC., ST. LOUIS, MO

Mr. **Druger**. Yes, Mr. Chairman. Leonard Druger from Citicorp.

We have for the last 10 years been offering a mortgage power program. We have made loans to 450,000 consumers to taking $50 million over that time frame.

In every one of those cases, we have positioned the consumer to be in control of the transaction. That is, there is full disclosure if there is a fee being charged for the service, and they hold the checkbook and we disclose promptly whether or not there is any payment by the knowledgable consumer.

We have had literally no consumer complaints and have had very high satisfaction with that approach.

So to the question of whether the consumer is protected by the proposed regulation, to the extent that the consumer holds the checkbook and is still in control of the transaction and is covered and enlightened by full disclosure up front, our experience is in fact that the consumer is not only protected but very satisfied with the result of the transaction, and is positioned much better to make a decision on what kind of financing is appropriate for him.

We essentially have had no problems on complaints with our program.

STATEMENT OF STANLEY M. GORDON, COUNSEL, PRUDENTIAL REAL ESTATE AFFILIATES, NEWPORT BEACH, CA

Mr. **Gordon**. Mr. Chairman, Stanley M. Gordon representing the Prudential Real Estate Affiliates. Under the Prudential system, there is no charge to the borrower, although there is "services rendered" compensation from the system provider, which is Prudential, to the real estate broker company operating the system.

I believe that the HUD proposal should encompass—and we have no objection to—disclosure if the real estate broker is still receiving some compensation but the borrower is not paying anything, and that disclosure is currently being made in the operation of the system.

STATEMENT OF DONALD HENIG, PRESIDENT, NATIONAL ASSOCIATION OF MORTGAGE BROKERS, PHOENIX, AZ

Mr. **Henig**. Mr. Chairman, I think we are missing the point. I don't think the problem is technology.

I don't think anybody at this table will disagree that technology is good in the industry whether real estate brokers are paid for obtaining mortgages for their clients or not. The industry will continue to grow toward technology.

I am a mortgage broker. My firm is completely computerized. The point is that there is a serious conflict of interest, and I think we have to take time out and not ignore this conflict.

The conflict is so severe that consumers are being hurt consistently.

The best point, and Mr. Druger brought up that in his firm there had been very few complaints—well, I have made this offer to the House, and I will make the offer to you, to take you or any member of your committee to the Queens, New York, market where Citibank founded their Mortgage Power Program. They control well over 20 percent of the market.

Citibank in that market has one of the highest rates and points in the market. I fail to see the benefit of high rates under any circumstance.

I have heard them say that a 15-minute commitment is a tremendous service. I think any lender that you would want to go to and ask them if we show them an application of a client, a credit report, and tell them that it is all true, would they issue a commitment under these circumstances, they would all say, yes, we would.

Citibank puts the word "commitment" on top and makes it subject to verification of every piece of information that is on this document, including the appraisal, including income verification, asset verification, the whole ball of wax.

I fail to see a "service." If anything, I think that when a real estate broker receives a fee for doing both ends of the transaction, there is a disservice to the consumer.

We can prove it very easily by showing this committee the Queens market where consumers consistently pay a higher price for this service.

STATEMENT OF MICHELLE MEIER, COUNSEL FOR GOVERNMENT AFFAIRS, CONSUMERS UNION, WASHINGTON, DC

Ms. **Meier**. Mr. Chairman, I am Michelle Meier with Consumers Union.

In many respects I agree with the last speaker. Consumers Union is very concerned with this development from the standpoint of the potential it holds for brokers steering consumers to mortgage products because of the financial interest they have in obtaining a fee either from a consumer or from the lender-operator of the Computerized Loan Origination System.

Because of my lateness today, I did not get to hear the HUD person who apparently went through HUD's proposal, although I was informed somewhat of what the proposal is, to open up systems so that Citicorp's system would have to allow other lenders to get onto the system and there would be some regulation of fees in terms of what the fees could be.

Certainly I think that would be a step in the right direction, but it still presents concerns for us, for consumers.

I do not know if the HUD proposal is to allow universal access to these systems, or greater-than-one-lender access—Universal access? [nod of agreement from Mr. Keating.] OK.

In that case, our concern would be that a lot of lenders in the market have the ear of the consumer through the real estate broker, and oftentimes that is how they get the ear of the consumer is through referrals from the real estate broker, and they would in essence be forced to join the system.

In some cases that would not be economically efficient, for example, a local lender who unless it joins the system and pays the fees that it is not now having to pay would not get the business that it is now getting through the referrals from the real estate broker.

That would be our concern, not that we would dismiss the HUD proposal out of hand, but we still think that it raises some problems for the consumer. The bottom line problem there is added costs.

STATEMENT OF STEPHEN ASHLEY, PRESIDENT AND CEO, SIBLEY MORTGAGE CORP., ROCHESTER, NY

Mr. Ashley. Mr. Chairman, Steve Ashley representing the mortgage banking industry.

This morning I would like to build on one of Mr. Henig's comments. That is, that technology is not the issue that we are debating today. Technology is a natural development.

Our concern from the mortgage banking industry point of view is that technology should not be used as an excuse to drive up costs or to increase profitability, and it should not be used to create barriers of entry to lenders that may wish to participate but are locked out.

Our concern with the HUD draft, a statement that was issued yesterday, is that work be done to maintain open access that would prohibit lender lock-out and would assure multilenders access on a CLO.

We are very concerned with fee structures where fees are paid for work that then has to be duplicated by the lender, and we are concerned that fees in themselves simply work to the disadvantage of the consumer and that there can be opportunities for further abuse of loans being steered, if indeed lender fee programs are permitted.

Mr. Druger. Mr. Chairman, I think it might be helpful to talk a little bit about our experience with consumers using the Mortgage Power Program and what the program is, because we like the pioneers of days of old have received all the arrows. We do not want our covered wagon to be taken away as we build a new way of doing mortgage lending to consumers in this country.

We started this program 10 years ago when the lending industry abandoned the consumer. We were the only lender in New York, as you will remember.

Mr. **Henig**. We appreciate that fact.

Mr. **Druger**. And we have made sincere efforts over the years to develop a better way to make mortgage loans, and actually to provide them at lower cost to the consumer with new technology, more information, multiple lenders.

We do not believe in single-lender activity. We in fact encourage our members to have more than one source, and in fact they do. We get less than 20 percent of our volume from any single lender.

They have two, three, five sources, and we in fact encourage that. The fact is that the Mortgage Power Program is designed not to cause payment of referral fees—and in fact discourages adverse steering.

If there is any potential adverse steering, when the realtor represents the seller, it is negated to the extent that they have an obligation now to the buyer, because he is paying the fee. It is not the lender that is paying the fee, we do not believe in referral fees by the lenders.

We are absolutely opposed to it.

But to the extent that a consumer pays a fixed fee to a realtor for a service that they want, there is no disadvantage.

There is no motivation to that realtor to offer anything but the best service. They are not advantaged by referring them to Citicorp, Prudential, or any other service.

In fact, the fee paid by the buyer negates, if anything, the tendency, if there is one, to represent simply the sellers' interests. Sixty percent of consumers reach out to realtors and ask for advice as to where to get a mortgage, with or without the payment of a fee. Where shall I go?

Typically, a realtor will say, here are one, or two, or three sources.

They will do very little work, because they do not receive any compensation to cover the costs, and that consumer will go to one of those three lenders. Now they are providing a full range of service.

They are providing application help. They are providing packaging of the mortgage. They are counseling the consumer and giving him a complete analysis of the different alternatives which are not just Citicorp.

Mr. **Henig**. I do not want to interrupt you, but that is their job. They are being compensated for this. They are getting 6 percent or 7 percent from the seller, and that is their job.

It has been found in the *New York State* case just recently this year—I think it was the *New York State Department of State* v. *Home Market Services*, where the Department of State found against the real estate broker who was also doing the mortgage and found that the real estate broker was operating in the wrong because they tried to get the best rates and points for the buyer, and if they were doing that they were ignoring their fiduciary responsibility to the seller.

The situation is that they are being paid for that.

Their job is to get a mortgage for the buyer, but not the best mortgage for the buyer, the best mortgage for the seller.

Mr. **Druger**. They are being paid for the realty transaction. They are not receiving 6 percent, as you know. That is split many ways. But that is not the issue.

They are being paid by the seller to help consummate the real estate transaction, which obviously includes the help required to find a lender. But they do not have to hire a financial service representative to counsel the consumer where it will do the consumer the most good, which is when they buy the house at the point of sale.

They do not have to go through the process of showing that consumer 50 or 60 different loan alternatives and try to figure out which one is best for that buyer.

They do not have to issue disclosures to show them exactly what their closing costs will be if they buy this house with this mortgage.

STATEMENT OF NORMAN D. FLYNN, PRESIDENT, NATIONAL ASSOCIATION OF REALTORS, WASHINGTON, DC

Mr. **Flynn**. Representing the brokers' interests here, let me jump in here.

My name is Norm Flynn, president of the National Association of Realtors.

On behalf of the realtor community, let me suggest to you that once a contract is perfected—that is to say, that you have negotiated the price and the buyer and seller have agreed—there are contingencies to be removed, and it is in the best interest of the sellers to get that as quickly as possible.

Therefore, in representing the buyer it is not a conflict legally or practically in that transaction. In fact, in assisting them to get the best mortgage the quickest they can and removing that contingency most practically, it is in the interests of both parties in that transaction and no conflict really exists.

Mr. **Henig**. The conflict is that by getting the mortgage for them as fast as possible, as you are saying, for the seller, now the buyer has to pay a higher rate.

This is done all over this country, but primarily in Queens where this program started.

Then, there is a serious conflict. People are paying too much for their mortgages.

Ms. **Meier**. Before you take the mike away, Norm—[Laughter.]

I think even how you laid out that scenario you have drawn a conflict. It may be true that both the buyer and seller want a loan commitment as soon as possible and a loan approval, but the buyer, unlike the seller, also wants the best terms possible.

So the realtor in representing the seller is going to ignore the term issue, whereas it would be in the buyer's best interest to get both speed and good terms.

Mr. **Flynn**. I do not know of a single seller that wants the buyer to pay the highest possible rate.

Ms. **Meier**. Of course not, but basically the seller is indifferent.

Mr. **Flynn**. Indifference does not mean a conflict. If one is indifferent, then the other one cares for it and they both would really like to see the best possible terms because it does not disadvantage them. It is not a conflict.

Ms. **Meier**. It is a conflict if getting the quickest commitment possible forecloses getting the best terms possible.

Mr. **Ashley**. Mr. Chairman, also on this conflict question, if indeed a realtor is receiving a fee from whatever source, that enhances the conflict.

The realtor then has an interest, a financial interest, in which lender that loan goes to. That is point one.

Point two is that if the consumer is being forced to pay for work that then must be done over again, we have increased the cost to that consumer and that is not in the best interest of bringing sound housing at affordable prices to the home buyer.

Mr. **Gordon**. The lender picks up the ball when it is at the underwriting stage. The real estate broker is now performing a mortgage brokerage function.

If that is not valid, let's stop paying the mortgage brokers. If they are performing a function up to the point of application, OK?

They are doing more than that.

They are working with the consumer, reviewing products, and they are getting the consumer involved in the transactions and learning about what mortgage they are going to select, which works a lot better than the current referral arrangement that exists today.

Second, the loan pricing and the cost to the consumer is the same. Under the Prudential financial system, the loan price is the same whether the consumer goes to this system or outside.

Under the borrower pay system, it is the same price as under the mortgage brokerage arrangement, and the consumer is not harmed at all. They are now being involved in the transaction.

If there is any conflict out there, let it be resolved at the statewide level, because every State has its own view on that, and frankly I do not see any States prohibiting real estate brokers from being in this activity.

STATEMENT OF DON MAIOLATESI, EXECUTIVE VICE PRESIDENT, D & N MORTGAGE CO., TROY, MI

Mr. **Maiolatesi**. RESPA in 1974, as you pointed out, one of its main reasons for coming on board was to make sure settlement costs and the use of kickbacks and entitlements through the lending industry was put to an end.

I was in the business then, and I saw it, and it was ridiculous. But in 1974, it ended just as fast.

On March 31, it came and ended on March 31, until cracks started opening it up.

The cracks were the *Graham* decision, and an informal HUD opinion letter.

As soon as we had cracks in the system, we started working our way back into how much can I make on this deal. That is what has happened here.

Mr. **Druger**. Mr. Chairman, I think there is a tendency to cloud the real issue here.

I do not think there is anybody around this table that would endorse the payment by a lender of a referral fee.

We certainly do not, and I do not believe the Realtors Association does, and I know the Mortgage Bankers do not, of whom we were the largest member. [Laughter.]

Until we just resigned, frankly, because of the way this issue is being addressed by the association.

I can tell you, maybe to clear the record up and to create, if nothing else, more credibility, that most of our business comes from the Mortgage Brokers Association.

Mortgage brokers produce most of our volume. We are at risk in taking the position supporting the Realtors Association because most of our membership sits across the table from us.

Mr. HENIG. I have seen the surveys. I have spoken to you——

Mr. DRUGER. If I may, let me just address the three points that I would like to make, and then I will turn it over to you.

STATEMENT OF PEGGY MILLER, LEGISLATIVE REPRESENTATIVE, CONSUMER FEDERATION OF AMERICA, WASHINGTON, DC

Ms. MILLER. I would like to make some points, too, to broaden the debate.

I do not think we have on the table all the points that are related to the concern at hand.

Right now we are having an argument between the realtors and the mortgage brokers and those who will all benefit from the financial exchange taking place.

Sure, there is an understandable incentive in terms of moving this product into the broker's office.

There is no question that that is the perfect place to have the connection take place.

One of the concerns there in moving into the broker's office is you are utilizing the very point of sale where the consumer, the buyer, will have the strongest incentive to close the deal right on that day even if it is not in their best interest, point one, which has to be a serious concern.

What I am laying on the table is a direct and strong concern over the relationship of moving this facility into the broker's office, pure and simple, whether we want to cross that line and allow the real estate office to become the mortgagee—because that is precisely what is occurring.

The benefit of that to the consumer is questionable. They do get immediate lock-ins.

That is a benefit. What they lose is a point of decision in that hesitation when they are forced to walk out of the office and have to think about possibly one of the most major abiding decisions in their lives that can cost them points, that can cost them buying into a mortgage lender which may not be in their best interest, and they may pay higher points.

But that point of decision often works in their best interests.

Point two, no one is talking about the appraisers connected to these mortgage lenders.

We are extremely concerned about systems being developed where that buyer walks in, locks in, and has had no chance to assess the appraiser situation. That on a local level can be a really strong problem.

Point three, we are talking about information. If we are talking about information, let us really talk about the technological era.

Let us talk about what consumers need in terms of information, not just what from a profit standpoint the companies here would like to provide the consumer.

From our standpoint, if you want to argue information, then let us put all the facts on the table.

Let us have systems that, if that requires the Government getting involved from the standpoint of having the consumers have access whether to the broker's office or in a mortgage lender office, or in some other Government office, but access to all the interest rates available.

We have here Citicorp. We have here Prudential. We have a number of other institutions wanting to develop systems.

When you ask them, will that information provide all the interests rates available and all the information the consumer needs to make the best decision at hand, then they might be talking, but that is not what is on the table.

So if you want to talk information, let's talk information. Then I will talk information. If we are not talking information, we are talking pure profit.

If you are going to do that, I would not recommend that that be done in the real estate broker's office, because then you are connecting the consumer to making a decision with a lot of pressure that is being put on them by people that have not the buyer or the seller really at interest. They have themselves at their interest.

Of course they want to sell. They want to close, and they want to make money.

So those are, in my opinion, all the subjects at hand.

The final point is that in our opinion we are very concerned because this will also have a distinct and strong impact in terms of financial concentration. We have to be serious about that concentration.

We are getting concerned about that concentration. The result of that is, many more banks will close because they will lose one other edge.

If we want that to happen, let us at least have our eyes open that that is what is going to happen. Then the consumer will lose all the other services they get out of those banks which do not have to do with mortgages. That is the other final concern we have.

So this is a very serious stand. We do not like the decision that has come about.

It was a tiny step to improve a disastrous situation which we think should be stopped.

Mr. HENIG. One of the things she just mentioned that we cannot get over, and I do not think anybody will deny that real estate brokers have the ability to steer a client to any lender that they want. They have that ability.

We are not here saying that they all are bad real estate brokers and they all would do this. We are saying they have the ability.

The incentive for them to do this is, number one, doubling their income. On average, you said 6 percent that they have to split a number of times.

You are right. Real estate brokers take a 6 percent commission and normally will have to split it with the other real estate broker, and now they are down to 3 percent.

Then normally they split it with their sales person, and they are down to 1.5 percent. They are making more on 1.5 percent on a mortgage. All they are doing is doubling their income without increasing their expenses.

One last thing just to touch on this, the other thing that has me concerned with this ability to steer is fraudulent loans.

It has become a major problem. We have been hearing from FHA that fraudulent loans are a major problem.

I spoke with Freddie Mac last week. Fraudulent loans are a major problem.

I asked them the question: If real estate brokers were out of the loop, if real estate brokers were not originating loans with that incentive for them to commit fraud, do you think the fraudulent loans would be as great as they are today?

The answer that I was given in public was, no, we don't think that would be as great.——

Mr. DRUGER. Mr. Henig, in support of Ms. Miller's position, let me ask you a question because we are concerned about the consumer, too.

That sounds strange, but the fact is—let me ask you the question:

A realtor is motivated to close fast to satisfy the seller. Right? Therefore, there is a clear conflict. They are going to be motivated to get the fastest loan, not the best loan.

Now the realtor now receives a fee from the consumer, not from the lender. Nobody supports lender-paid refund fees, none of us.

The consumer holding the checkbook says, I want service and you tell me what the best source is. You counsel me. You help me put this package together.

The consumer is paying the flat fee of $250, $300, whatever the fee is, it is a flat fee.

Why are they motivated to go to one lender over another lender? Are they not less motivated to go to the fastest lender because they now have an obligation to the buyer as well as the seller?

Mr. HENIG. So if they are taking a fee, their motivation stays the same, to go to the fastest lender possible.

Mr. DRUGER. Why?

Mr. HENIG. To close the transaction for the seller. They go to the fastest lender possible, even if it means higher rates.

Mr. DRUGER. Time out. They are already motivated to go to the fastest lender. Now they are being obligated, contractually obligated, to provide a service to the consumer.

Mr. HENIG. Now they are receiving a fee.

Mr. DRUGER. But they have a fiduciary obligation to the consumer to find the best possible loan. Are they not less motivated to go to the fastest lender.

Mr. HENIG. They do not have the fiduciary to the consumer.

Mr. Druger. They are getting paid to represent the consumer. The consumer will not pay them unless they get the best mortgage.

Mr. Flynn. If these abuses you are talking about are so widespread, if you believe the testimony, and I do, the testimony that HUD gave yesterday, less than 1 percent of all the mortgages are ever processed through CLO's. So if 99 percent are somewhere else, those abuses are in your own camp. Let's start there.

Even mortgage referral systems in our own real estate community is a very small percentage that do their own originations in their office.

The fact of the matter is, what you would like to do is fence them out and box them out. So it is your opportunity to do it.

I really like HUD's material. Let me make a broad statement about the HUD program, first.

On balance, I would like to compliment HUD for, after 2 years of waiting to bring forward this information, that they are now taking an affirmative step to clarify and give some new opportunities in the marketplace for it to progress in the 1990's into the year 2000 and beyond, to open the door and allow consumers access to information as quickly and as conveniently and as efficiently as they possibly can.

I think that is the real bottom line for what the technology does.

Senator Cranston. We should try to zero in now on the HUD proposal. We have had a very lively and a very sharp discussion of the fundamental issues involved here.

What we face are the HUD proposals in regard to this. Could we now focus a little bit on that?

How can they be improved?

What more could HUD do to ensure that abuses do not emerge?

Mr. Flynn. Let me focus on that. When I started my comments, I wanted to bring it back to that because I know we started with that, and that issue was focused on what the regulations would be and what additional legislative adjustments would be required above and beyond this.

On balance again we as realtors agree with HUD's proposal. In Mr. Keating's presentation yesterday, we found two minor, or not so minor, but two exceptions that we have today.

We do take some exception to the fact that they are looking to cap mortgages, or to cap the fees that might be paid.

We believe that the marketplace itself would cap it, because whatever cap you put on them will not be a minimum or a maximum rather, it will be a minimum.

So anybody that is on a system will automatically have to pay it.

If it were left to the free-market open system, perhaps that fee would be less, and perhaps it would be even more de minimis than the one that is there.

Given the fact that Mr. Kemp is a pro-free enterprise person, we were a little surprised that this was not what we consider a free enterprise but a price control mechanism there.

Last, does the proposal go far enough? If you cap us, why do you not cap the mortgage brokers and bankers at the same time for the same services to lenders.

If you are willing to do that, perhaps that would be a program that we would be willing to agree with.

The last comment I guess is the multiple-lender options. We in fact as realtors favor multiple lender options, as Mr. Druger has suggested.

However, to mandate any specific number and how many that is perhaps would be inappropriate.

The marketplace itself will allow it to happen. There will be informal networking like the ATM's which started out at each bank with the automatic teller systems having their own, and now you are seeing regional and national networks of ATMs where multiple access was given many, many consumers.

They have the convenience and opportunity to get to that source of information quickly and conveniently. So on balance we favor it, with a couple of minor adjustments.

Senator CRANSTON. Any other comments on the HUD proposal?

Mr. ASHLEY. Mr. Chairman, I would like to pick up on what Mr. Flynn has commented on. We feel that the HUD proposal of yesterday does move this discussion in the right direction.

However, I would like to address your question very specifically. There are some areas that we think HUD could act, and act positively on to improve it.

Specifically, one, the fees as we understand it that have been indicated in the discussion we think are too high.

We think that something in the $100 to $150 range, as discussed, would be perhaps more appropriate.

Secondly, we think that a distinction has to be made between fees paid for simply electronic rate sheets and prequalifying versus honest to goodness processing—that being work that would not have to be duplicated, as I commented earlier.

Third, we think that the 2-year phase-in period is too long. There is no reason why it could not be limited to 6 months.

This is not something that we need to give 2 more years of the kinds of situations in the marketplace that Mr. Henig has referred to to continue.

And last, we would suggest that private opinion letters be rescinded.

We do feel that the discussion is moving in the right direction, but we feel that more concern has to be paid to these matters and to the open access that has been commented on.

STATEMENT OF JIM MERRION, SENIOR VICE PRESIDENT, COLDWELL BANKER RESIDENTIAL GROUP, MISSION VIEJO, CA

Mr. MERRION. Mr. Chairman, I am Jim Merrion with Coldwell Banker-Sears. We are a fully diversified company in the industry for which the designation "controlled business" fits. We offer title escrow services, homeowners insurance, home warranties, mortgages and other real estate services.

We offer real estate brokerage services through 40,000 salespersons nationwide, many of which are members of the National Association of Realtors. We support NAR's position on the RESPA issue. Through Sears Mortgage Corporation are also members of the Mortgage Bankers Association.

I am afraid that we have perhaps gotten off-track, as we were listening to what we would view as an anticompetitive measure that the MBA has introduced.

But in response to your question about HUD's proposal, we believe that payments should flow between the parent and the wholly owned subsidiaries, or two wholly owned subsidiaries should qualify as a "controlled business" exception under RESPA.

We also believe that real estate brokers should be compensated by a buyer or a lender for fair value of the mortgage services performed.

The issue at hand is alternative distribution methods in the real estate industry. There are services which are, instead of being provided by a mortgage lender, being provided by a real estate broker.

Through our own mortgage company we found it was more costly to distribute mortgage services through a mortgage broker than it does if we use a real estate broker.

We also believe that RESPA should be interpreted so as to allow packaging of real estate services with genuine consumer discounts. And of course we support full disclosure and no required use.

In addition, I would like to mention that we are talking about a very copmpetitive markeplace with 7500 to 10,000 lenders. The largest mortgage lender only gets slightly over 3 percent of all mortgage business nationwide. In addition to that, there is a variety of products.

This also happens at a time when you see that the nation's largest real estate brokerage company, Century 21, owned by Metropolitan Life, has just dropped out of the mortgage business.

They quit the business altogether. I think we may be getting wrapped around the axle in looking at the scope of the issue, and I think we need to keep it in perspective.

We do believe we can offer consumers fair discounts by the bundling of services. We believe HUD has taken some positive steps, as we read the testimony that Mr. Keating furnished yesterday, and we compliment HUD for addressing the issues.

Senator D'AMATO. Mr. Chairman, I have a question.

When you mentioned Century 21, you said it dropped out of the business. Are you talking about referrals of mortgages?

Mr. MERRION. We are talking about the mortgage business. I noticed in one of the realtor publications, Realtor News, that over the next 9 months they will be phasing out of the retail mortgage lending business.

This action demonstrates that it is a very competitive industry.

Senator D'AMATO. Let me ask, to just get everybody a little more angry at me—and I have a pretty good batting average here—consumer people are never quite happy with my position, the realty people are angry with my position, the mortgage bankers are angry—so I am batting 100. And with Keating & Company, we will maybe go from day to day.

Maybe it is old-fashioned, but why should a real estate broker get his commission from the sale of the house and get $200 for referring somebody to some mortgage company?

Mr. FLYNN. He shouldn't. He should get it if they provide services.

Senator D'AMATO. What is the service, really? Let us not play this game on technical grounds. Let us get right down to it.

Mr. FLYNN. We contend——

Senator D'AMATO. Forget Citicorp. I do not care about whether it is Citicorp or anybody else.

I just want to raise the thing. Someone comes to me to sell my house. Yes, I get my commission. It is a competitive business. It is tough today.

I recognize that. But why should I get paid anything for saying to Pasquale who comes in, in this little community, he just wants to get out of the city, he finds this little hamlet, whether it is in northern Virginia or whether it is in Long Island or any other place, and he comes to this broker and they take him around and show him a house. Terrific. The broker is happy.

Now obviously it is in his interest to help get Pasquale a mortgage. He does not know the first place to go. He does not know what to do. Why should they get paid for that?

Mr. FLYNN. They should not.

Senator D'AMATO. Who thinks they should?

Mr. FLYNN. And they do not.

Senator D'AMATO. What is this provision about $200?

Mr. FLYNN. Let me just take a side step here, if I can, Senator, and explain the difference.

On services rendered, the mortgage bankers, called "loan originators," and the banks and S&L's call them loan officers, they are the people who, when Pasquale goes to X, Y, and Z, he sits down with and they provide him with information.

They ask the questions, do the profile, prequalify the person, get all the verifiable information and put it in a package.

Then it is passed to an underwriter. It is then verified. It is what he calls "duplicative service" and what I am calling "substitute service."

If the broker substitutes for the loan originator or the loan officer, then the lender does not have to pay those players.

If he does not pay those players, there should be a fee for that extra work and effort that they put into prequalifying and prepackaging that application and following through until the loan is complete.

That is what the services are that are actually being paid for. It is a substitute for that which is already on the market.

If someone is going to go and do that additional work, I am going to say, Pasquale, why do you not go to X, Y, and Z, and if you make your way in there and it works for you, then that is fine. And Pasquale cannot figure it out, and he is intimidated by loan originators and the process itself, and he falls out of the game. Then it is not in his or her best interests.

Ms. MILLER. I have a comment on that from the consumers' standpoint. The brokers already do that.

I mean, when I have gone to buy a house—and everyone else I have talked to—it is in their best interest. They do not want to waste time with somebody who cannot qualify for a loan, period.

So about the first thing they do, in their interest, is to check out your situation. Then, if they arrive at the conclusion that you can purchase a loan, then they go ahead.

Then at that point, it is also in their best interests—being paid by their commissions, so they are getting reimbursed for all this, and it helps them sell a home—if they then go and give the information as to mortgagees, et cetera.

Now they tend to usually give you information for those they know will either close the loan the fastest—you know, who they have got relationships with—and they try to steer you in that direction.

From the standpoint of information, there is some benefit to this information. Our concern about information being in the broker's office that it is not total information; that if you are going to go and take the position, which we do not feel you should, that it is already in there, and so now how do you restrict all the way back to not having this in a broker's office at all—but if you are in the broker's office, then what would really benefit the consumer, since that is what we are talking about here, is all the information.

So one of the things that I would to have considered here is that if you are going to have this in a broker's office at all, have it be that they have to provide all information, the information systems, to have them provided when that consumer is sitting there in that broker's office, not just by who they get to charge a fee for because they have tied in with a couple of the big guys that can handle setting up the systems.

So that with the systems, if you are going to take this step, take it all the way and require that the information is total. Have the guys with the low interest rates on that list, too.

Mr. FLYNN. Let me ask a question, Ms. Miller. Would you ask them to extend that, then, to the banks, the S&L's, the mortgage bankers, and mortgage brokers that they do the same thing?

Ms. MILLER. As I was pointing out in my position, when you are in a broker's office, a broker has a different responsibility.

I would not have them in there at all. A lender is a lender, and the consumer walking into a lender's office recognizes that that lender is there to close a loan.

When you walk into a broker's office, you think you are going in to buy a house and you do not think you are going in because you are buying a house plus that person has got a connection to a given lender and they are going to close and maybe become the mortgagee also.

Mr. MAIOLATESI. May I please respond to that, Senator?

Mr. Flynn said earlier that he is just trying to get remunerated for services performed, and he is against kickbacks.

I do not only suggest to you, I tell you as a fact that there is what we commonly refer to in the industry as a "lender lockout." Real estate companies lock out lenders and give direct referral fees, not for work performed, referral fees, to their agents to send them to a specific lender or brokerage outfit that they get the money for with no services performed, none whatsoever. That is rampant throughout this country, absolutely.

Ms. MEIER. What does that go to? I would say that is another problem, and it doesn't change the fact that this is a problem.

I do think that the nub of the distinction here between the realtor qualifying and preparing the mortgage application with the consumer and giving full information on the other products available and, for example, the bank doing that is that again the realtor, as Mr. Druger said earlier, is in the key position to advise the consumer.

The consumer relies on the broker for some good, impartial advice. Sixty percent of consumers ask for the broker to play this role.

So again the consumer is looking for impartial advice, not advice that is tainted by his representation of the seller or the fee that he is going to be able to recover.

Now it is true that in some cases there could possibly be some substitution by the broker of services performed by the lender, not just duplication of services that are already performed, but the real question is whether or not we want those services to be performed by the broker.

We want to discourage consumers from exclusively relying on the real estate broker for information and processing of mortgage loan applications because the consumer should not just rely on this person who has a fiduciary duty to the seller.

Mr. MERRION. I think you are selling the consumer short, Mrs. Meier. If you look, every newspaper has columns full of mortgage rates available. There are 24-hour updated daily 800-number hot lines.

Ms. MEIER. You know, it actually makes me mad to hear that. There is so much misinformation about mortgage loans. It is so difficult for consumers——

Senator D'AMATO. May I ask a question?

Mr. Druger, you wanted to say something?

Mr. DRUGER. Yes. I wanted to respond to your first question. [Laughter.]

Senator D'AMATO. I will give you a twofer, all right? [Laughter.]

There is the real estate broker who performs the service for Citicorp. And Pasquale, this mythical guy, comes and gets referred over, and Citicorp gets $500 for doing all this work?

Mr. DRUGER. May I describe what the work is, sir, to respond to your first question, and the second at the same time?

Senator D'AMATO. Is it a maximum of $500?

Mr. DRUGER. No. There is no fee prescribed for the service. In fact——

Senator D'AMATO. How much do you pay them?

Mr. DRUGER. We do not pay anything.

Senator D'AMATO. You do not pay?

Mr. DRUGER. We do not believe, and we do not support any kind of lender payment for a referral.

Senator D'AMATO. Any charge up to $500?

Mr. DRUGER. We do not pay them.

To respond to your first question, which I think was answered partially by Mr. Flynn but not completely, when Pasquale comes in to one of our offices in Island Park, or Ocean Side, or any place, and he wants to get a mortgage, he comes into the realtor's office, there is a computer terminal.

Thirty percent of our members have computer technology, which is what this is really all about. Ultimately it is the future; it is not today, it is the future.

There is a computer terminal in that office. The realtor can either dial in to 1 of 50 lenders on Readymate's system or Citicorp, so it is not restricted.

When the realtor asks Pasquale sitting there, Pasquale says can I afford this house? Can we make the mortgage payments? What is my best mortgage alternative? Then the realtor will dial in and produce a complete analysis using Fannie Mae or Citicorp's program, of what the alternatives are and screen for Pasquale's situation.

He is self-employed. He is a gardener. He does not have any easily verifiable income. He will select 10 lenders that effectively offer low-documentation programs.

He will look for the lender that provides the fastest service and the best rate, and he will ask Pasquale what is important to him.

Senator CRANSTON. I have to interrupt at this point. I want to strike from the record the references to Pasquale.

Mr. DRUGER. I am sorry.

Senator D'AMATO. That is a mythical borrower.

Mr. DRUGER. A mythical person. Why do we not just call him a consumer. [Laughter.]

Senator CRANSTON. I would like to ask that we strike from the record references to Pasquale.

Senator D'AMATO. I join the Chairman. You are right, Mr. Chairman.

Mr. DRUGER. OK.

Senator D'AMATO. You are right, Mr. Chairman.

Mr. DRUGER. The consumer will then be given a choice of lenders.

The realtor would not only provide him with a complete disclosure of exactly what his monthly payments will be with all of these alternatives, but exactly all the items of all closing costs. Now full knowledge and full information, and he can decide which lender, which product, exactly what his closing costs will be, and whether or not he can carry the mortgage.

But on our system he will actually produce through the computer terminal a Citicorp commitment to the consumer. It is a real mortgage commitment, in 15 minutes or less. That is the future. That is the technology.

Senator D'AMATO. Now let me ask you something. If this is broker XYZ, does the Citicorp have any objection to him having the same kind of relationship with others?

Mr. DRUGER. No. In fact, he does. We encourage——

Senator D'AMATO. You are saying you do not require an exclusive?

Mr. DRUGER. We refuse to allow an exclusive. We do not have an exclusive.

Senator D'AMATO. Then yours is a service which you make available. All right.

In the present situation, Frank, is there a cap as to what that realtor can charge for this service?

Mr. KEATING. Senator, part of the Kemp proposal is a cap, and also full disclosure and full access. That is all part of the funding that HUD proposes.

Senator D'AMATO. Nonexclusivity is one of the things contained in the proposal?

Mr. KEATING. That is correct.

Senator D'AMATO. And a cap of, what, $200?

Mr. KEATING. $250 to $300.

Senator D'AMATO. You have not formalized that yet?

Mr. KEATING. That is correct.

Senator D'AMATO. What do you say about that?

Mr. FLYNN. Actually, we again in talking about the cap think there is a problem about putting the cap in.

Under the current Citicorp program there are a number of users which are zero. They provide that service at no cost. That is the way they conduct their business.

Senator D'AMATO. What do you think? What does your Association think?

Mr. FLYNN. My association believes that there should not be a cap, that the free market should set a cap on the maximum or the minimum.

Senator D'AMATO. And you think that there should be real competition?

Let us swing around here. You have had a pretty good shot at this.

Mr. MERRION. Senator D'Amato, what I would like to say is I am a real estate practitioner, and within the office I think it would be—theoretically, one of the problems I am having with the discussion is that we cannot tell our people, you know, you place the mortgage with any mortgage company. They are independent contractors.

We cannot even get them to meetings on time, even though they would like to. They are very independent. Even in our company, while we have a real estate brokerage company and a mortgage company, 91 percent of the mortgage business goes to somebody other than Sears Mortgage.

So I do not think we are talking about a big issue. When they walk into our office, the agent really tries to help the borrower identify the best program.

In some of our offices we have the Citicorp program. In others we have hundreds of rate sheets sitting around. There is a variety of information available.

It is not easy to try and guide people in that direction. The consumers are more sophisticated today.

Mr. DRUGER. Senator, there would only be one really major concern about the cap, and this is the nub of the issue.

As a mortgage banker we understand the mortgage banker's position—that is, that to the extent they cap this at a level which does not allow a realtor to recover their costs, they will not be able to buy an IBM personal computer; hire a financial services representative that is resident in the office; he is not an agent; he is a professional mortgage broker.

Senator D'AMATO. As part of the requirement?

Mr. DRUGER. That is what has happened.

Mr. GORDON. The Prudential System also has an employee and additional costs in their offices.

Mr. **Ashley**. I think we need to focus just a minute here on the issue that Mr. Flynn identified earlier.

That is, the type of services in his view, and the views that I would represent.

We are talking here about services that have traditionally been provided by a realtor to the home buyer at no charge.

Now technology does make it possible to extend some of those services.

However, to the extent that we are simply using technology to display rate and terms' information of the marketplace, we do not feel that anyone should be paid by a consumer for obtaining that information simply in a different format than they previously did.

Second, on the qualification issue, we would draw the distinction and your attention to the traditional realtor role of prequalifying.

Ms. Miller made a very good statement to that, as opposed to actually taking an application and processing a loan.

That is where we get into the issue of duplicative activities with a lender, with the concerns we have today regarding load quality and the integrity of the loan process, and the lender has to do that work over, then there is no service or value added and the cost to the home buyer has gone up.

That is at the heart of our concern on fees.

Mr. **Henig**. Senator, could I just add on to your example before about the consumer? Earlier, before you were here, I mentioned that I would be happy to take anybody on this committee into Queens to show them what is really going on.

Instead of hearing from all of us, I am probably the only person here that actually writes residential mortgages today and knows what is going on on the streets.

In fact, those consumers are being hurt. I would be happy to prove this to you. The situation is—and you heard Michelle Meier giggle a little bit before, and anybody that I have ever given this example to, everybody seems to be able to relate to it, because it has either happened to them or a member of their family, especially in Queens and Long Island where you have heavy ethnic communities—the individuals go out to buy a home.

They are out with a real estate broker for maybe 6 months. They become friends. They have each other's home phone numbers.

They call each other at night. They are interested in the town, so they are invited out to town functions.

The real estate broker may babysit while the home buyer goes out with their parents to see the home again.

The biggest thing that we see is that then they go back to the real estate office and they are sold a mortgage. Why would they buy this mortgage when they can look in the paper?

First off, in many cases the real estate broker is wearing a shirt and tie and suit, and they look up to somebody with authority and to somebody with knowledge.

Second, the real estate brokers, in Queens especially, when we asked them this question, they say it is easy: Because we refer them to their attorney, as well. They are covered on both ends.

Consumers can look in the newspaper and see 20 to 30 different ads for lower rates than they are getting, but the fact is that when they are there in the real estate office they are easily steered.

One last point on the 15-minute commitment and on the speed of it. What that also means to the real estate broker, since real estate brokers typically accept or take their commissions at commitment, that means by getting that commitment in 15 minutes while the homeowner is still there, the homeowner is also writing a check for the real estate broker for that service, or for that commitment.

Ms. MEIER. I would like to jump in on two points. One is, I think the discussion has accepted as a premise that the problem addressed here is a function of the development of computerized loan origination systems and the advancement of technology.

You know, I think the technology involved here, granted, the technology is new but the interrelationships between lender and real estate broker and the potential of the availability of referrals to the lender is not really new.

I mean, we could have seen a development like this, and in fact have, through the development of mortgage brokers.

Lenders have gone into geographic markets outside of their brick-and-mortar facilities and have expanded the number of players in the market without this new technology.

So I do not think we should accommodate this development just because it is potentially offering new players when we can see new players without accommodating and indulging this market to the detriment of the consumer.

On the fee question that HUD has proposed, I share the concern of setting a fee ceiling because I do have a fear that it will become a floor and greatly exceed the costs that a lot of brokers will actually incur with these types of systems, and again add to the costs for consumers.

I also think HUD needs to very seriously look at the question of what needs to be disclosed.

My understanding is that they are looking at the good-faith estimate settlement disclosure as the place at which the consumer will find out what this fee is.

I think that is totally inappropriate, since that comes after the mortgage application is already submitted.

We need to have preapplication disclosure not only of what the fee is, if we are going to move in that direction, but also of the relationship between the real estate broker and the home buyer in terms of the broker representing the seller.

Because, as you know, most consumers do not know that. Studies have shown that.

Mr. GORDON. Mr. Chairman.

Senator CRANSTON. If I may put in this point—excuse me, but we are almost out of time for this discussion. I have to leave at 10:20 to preside over a meeting on the Persian Gulf situation.

There are two things I want to cover.

Mr. Keating, is there anything you would like to say in response to what you have heard, or any new thoughts you may have as to what we should do?

Second, I would just like a very brief comment from you, or any of you, as to RESPA.

Does it have to be revised? Or, if adequately enforced, can it give the consumer protection?

First, Mr. Keating.

Mr. **Keating**. Thank you, Mr. Chairman. I do appreciate the contributions of my fellow panelists. I assure the chairman and the other members of this panel that Secretary Kemp and I are sensitive to your concerns and will incorporate them into our final regulation, to the extent we think we can do so consistent with the statute, the will of Congress, consumer interests, and the interests of what we believe is advancing the technology.

I would like to suggest that my discussion at the outset was to discuss really the five pieces of what we are doing to attempt to advance the interests of the consumer under RESPA.

We concentrated pretty well exclusively on the computerized loan origination issue because that is an issue that is obviously of considerable economic importance to a number of people around the table, as well as of importance to the consumer.

What Secretary Kemp has attempted to do is not to split the baby in half and have both sides live, but to look at this piece and say: Is this technology which Citicorp has developed and which we have, as a result I think in error, given a private opinion letter to Citicorp to give them a temporary monopoly, is that a good thing for the consumer?

We are no longer going to give any of these opinion letters because we do not think it is appropriate to give one person a leg up over another.

We are intending to provide an opportunity for expansion of competition. So if everyone around this table, Mr. Chairman, is a little bit concerned about where we are, maybe that is a healthy thing.

What we hope to do is to encourage the advent of this technology, which we think is in the interest of the consumer, but by doing so in such a way as to ensure access of other people to the technology at a competitive rate, access to the consumer to the best information.

We hope that by adoption of these regulations on our Computerized Loan Origination System that a Citicorp System, as excellent as it has been—and we have had no complaints, none, at the Department from any consumer about the Citicorp system—that in the future there would be a similar system.

We would hope in the RESPA regulations to provide access to anyone and everyone who wishes to have their information similarly situated.

In some sections of the country there will be more information than in others.

I am from a section of the country, Oklahoma, where there will probably be a big blank. [Laughter.]

But there are a lot of sections of the country where we think a system like this will actually be good for the consumer because, in addition to the mortgage company down the street, he will have regional mortgage companies and lenders, national lenders, more competition, and hopefully at less cost.

Is there a referral fee or a kickback here? If a realtor who charges for these services is providing the services, we say no, provided the payment is for a service that is actually provided.

As a matter of fact, our feeling is that a fee earned must be really earned and not duplicative of other work already performed.

So if a realtor purchases this technology, purchases this software, purchases this hardware, and provides a wide range of potential loan services to a consumer, we think that is in the interest of the consumer.

Obviously the Congress can overrule that. Circumstances may suggest later that that was not a wise decision, but that is the Kemp view at the present time.

Should we cap that fee? It is the Secretary's view that as we look at this, the evolution of this product, we ought to suggest that the fee ought to be a reasonable fee for the service provided, which is $250 to $300 in our view.

Hopefully it will be zero, because we think again as there is more competition, as there is more expectation and there are more people on these systems and realtors who are offering the service, there will be less need for a fee or a lower fee.

We think that at the time that service is provided to have a disclosure given to the potential borrower, and signed by him, that says this is not the only loan available.

There may be loans at other and more competitive terms available elsewhere that are not even on this, and if you accept one of my products, 10, 15 products, or 3 products, I am going to be paid by you to provide you this service, we think that is in the consumer interest.

Again, we do not have 100 percent of the answers to 100 percent of the questions, but we think that RESPA is not violated by this advanced technology.

We think we need to encourage this system. We need to encourage consumer awareness and consumer disclosure, and we think we are acting consistent with the will of Congress by this proposed regulation.

Mr. Ashley. Mr. Chairman, I would just like to say in response to your question that our view is that RESPA will work if HUD vigorously enforces it.

We have been encouraging enforcement for the last several years and are pleased to read in Mr. Keating's testimony that the enforcement activities are going to step up.

I would further add a humble opinion. If you feel that the letters are inappropriate, or were issued inappropriately, that a withdrawal or a recision of those letters would now be appropriate.

Mr. Keating. Everything will be merged in the final ruling. [Laughter.]

Senator Cranston. May I say at this point that Don Campbell will carry on briefly until other Senators arrive for another hearing we have to hold this morning. We may have to have another hearing on this.

We have gotten a lot of information and different viewpoints that we need to try to absorb. We may want to have a further hearing on that.

It may not be necessary, but I thank you all for your participation, and I apologize for the brevity of our discussion, but I think we have covered a great deal of ground.

This will continue until we have to be interrupted by another hearing.

Mr. FLYNN. Mr. Chairman, we should invite additional written comments from those who want to make them and telling responses to other comments to you and other members of the subcommittee.

Senator CRANSTON. We will do that, and we will solicit any other comments provided in writing, and in particular comments from other members of the panel.

Thank you all, very much.

Mr. HENIG. I am unclear on one thing in your plan on "controlled business" arrangements.

I am not really sure what you mean there by controlled business arrangements. We know Sears and Coldwell Banker and we know Prudential and so forth, but what about the real estate broker that is in my marketplace that says to the consumer, instead of paying me, because now I cannot do that, or whatever, since you cannot pay me, pay my other company XYZ mortgage company because you can pay them?

What we have found is that many real estate brokers have either put a divider in their office, or have gotten a different phone number and a different name on the door as XYZ real estate, XYZ mortgage company.

They may be two doors next to each other.

So in most lenders' cases, are they getting mortgages from the mortgage broker or from the real estate broker? This company is only a mortgage broker or a mortgage banker.

Does your plan address these types of issues?

Mr. KEATING. Let me just mention what we have proposed on the controlled business arrangements issue, then I will attempt to answer your specific question.

The 1983 statutory amendments exempted those arrangements from the anti-kickback provisions, as you know, of RESPA, if certain disclosures are met which will be in the regulations.

RESPA permits fees under the controlled business arrangements if the referred party is told of the arrangement.

The referred party is not required to use the controlled entity, and no monies are passed between the referrer and the referee except for a return on ownership interest defined as dividends for partnership distributions.

In your case, it is a referral fee, in our judgment. It is very difficult to discuss hypothetically these things, but I would say in my judgment it would be a referral fee if it is a payment for services not performed by the person paid. So we would view that as biased.

Mr. HENIG. That person is representing both companies.

Mr. KEATING. If you have any cases, we would love to have them, but we are alive and well.

Mr. HENIG. What I just described to you is a large percentage of the cases on Long Island.

The real estate broker is sitting down and, for obvious reasons, over the past two years they have been changing the name of their mortgage affiliate. So it is a controlled business arrangement.

This is not a joke. This is a fact. They have either the first floor of the mortgage company and the bottom floor as the real estate broker, or vice versa.

So the person is sitting down, and you sign the binder for the house. Now, let me take you over here and let's fill out the forms of the mortgage. You simply walk across the room, but now you are in a different company.

Mr. KEATING. Again, as I said, it is difficult for me to digest hypotheticals, but I would say that any time a payment is made to an entity that did not provide the work, that would violate RESPA.

But any suggestion that you have as to potential cases that we ought to look at, we would be happy to look at.

I want to emphasize for the record that we have 107 cases under investigation right now.

Of those, 104 have been opened since Secretary Kemp came into office. So we are aggressively pursuing investigations. And if you have anything you want us to look at, please send them to us.

Mr. CAMPBELL. Mr. Druger.

Mr. DRUGER. If I may, first I would like to compliment you on taking a stand on RESPA and going forward under these proposed regulations.

In the context of the hearing yesterday, my understanding is that in addition to the 2-year phase-in, there would be a multiple lender provision or the mortgage power plus system if we issued a commitment on the spot within 15 minutes, we would also have to include provide that the realtor had local alternatives which we endorse.

The question is, mechanically, does that mandate that they must somehow be members of our program on our system? Because that is not within our capability.

Mr. KEATING. The mechanics of that obviously are going to have to be worked out as this regulation is drafted. We welcome the input of the membership around this table, because we want to make sure that what we write as a regulation is consistent with the consumer's interest.

I do not know at this juncture what the correct answer to that question will be.

I can say in a generic sense or a macro sense what the Secretary desires, that whatever is occurring today with respect to any CLO system after that 2-year hiatus have availability within it to honor the information from other competing parties at whatever level that may be.

Obviously it would have to be determined by the technology that exists in the office and the services that are proposed to be provided by that office.

We want to see an opportunity for as many parties as can be on the same system that provides the potential service.

Mr. DRUGER. The obvious dilemma is that Citicorp's system actually issues the commitment.

I somehow suspect that Prudential would be a little nervous about originating their commitments on our system.

[Laughter.]

Mr. ASHLEY. Mr. Keating, if I might interrupt, I think what Mr. Druger just said goes to the very heart of what we have been talking about here. That is, the use of technology to restrict the size of the market.

Mr. **Druger**. Technology, sir, does not restrict the size of the market, because in fact all of our members have multiple sources.

Mr. **Ashley**. But, Mr. Druger, you just said that your system does not permit other lenders to be used. I anticipate that it would be.

Mr. **Druger**. That is not correct. What I said is, we issue a commitment, that the same computer equipment gets access to the other lenders on different systems.

Mr. **Gordon**. If we had 70 or 100 lenders on the Prudential system, we could not do as much with the products to help the consumer.

Mr. **Druger**. A consumer can access multiple systems with the same computer terminal. All that happens is that there are two phone numbers. That actually is happening today in Schlott Realty. They offer Citicorp. They offer 50 other lenders.

Mr. **Ashley**. This is the variation that it seems to me HUD is going to have to address and deal with as they define what they mean by multiaccess and multilender capability; eight to a dozen lenders may be too restrictive in some markets, Mr. Gordon.

It may not be representative at all or give the consumer a viable product in that marketplace.

Mr. **Gordon**. It is better than a real estate broker referring them to one or two mortgage brokers today.

Let me just tell you what you do in reality.

Mr. **Henig**. Let me just tell you—this will just take one second to talk about the number of lenders. In my company, we represent well over 100 lenders, but the real number—and you have heard me say—is, on a monthly basis, we deliver loans to over 30 lenders a month. That is a real number.

Ms. **Meier**. What strikes me as curious about this discussion, and I think it really reflects practical difficulties, is its narrow confinement to CLO's.

Again, I think this problem could reproduce itself outside of the CLO system.

So is your reg just going to address computerized loan origination networks? Or are you going to say the same fee of $200 to $100 or whatever it is going to be would be the maximum fee that a local lender could also charge, or could also pay the broker?

He does not particularly want to get on the system and does not need to get on the system, but can pay the broker what right now he cannot pay?

Mr. **Keating**. No.

Ms. **Meier**. That is when you see that this really does look like a referral fee.

Because right now the local lender can not pay the broker any money to get this business.

Mr. **Keating**. If there are no services provided, then we would review it and view it as a referral fee. If services are provided, it is not a referral fee.

The Citicorp program and these other CLO programs will be examined.

If they are in fact providing services in our view, then they are not referral fees.

Ms. MEIER. Outside the CLO, the broker could also be helping fill out the application form, getting a credit check authorization, that sort of thing.

Will this reg address these situations that are outside of CLO's?

In fact, Citicorp's program is in the majority of cases outside of a computerized network.

Mr. KEATING. The reg that we are going with, the final reg, we have had 1600 comments so far, and another 1,000 after the comment period closed, so if there is additional advice you might wish to give us on how this should be drafted, we would be happy to accept it and to consider it in the course of redrafting.

Ms. MEIER. Just 10 seconds on Senator Cranston's question. Yes; I do think Congress very seriously needs to consider addressing RESPA, particularly in light of where HUD seems to be going with it.

I do have to also commend HUD. I do think they have done a lot of thinking on this, and I am happy to hear about their more vigorous enforcement of the law.

However, we do disagree on this. So I would like to see Congress continue looking at this and doing something even outside of this area. For example, Congress should review the escrow account issues that the attorneys general have been working on and give HUD enforcement authority in that area, because at least our New York Office was informed by HUD that they do not think they have enforcement authority in that area.

So there is a lot of room for improvement.

Mr. GORDON. In response to the chairman's question, we believe RESPA is drawn up properly and has the proper philosophical statements in there, and it is really the job of the regulator to flush that out and address all the different variations that can occur in the marketplace.

It is not possible to do that in a statute.

It would be inappropriate to add one line exceeding payments for mortgage services. I think it is up to HUD to address it, and it is now indicating a willingness to do so.

There is nothing wrong with the statute as it stands.

Mr. CAMPBELL. I hate to bring this lively discussion to a close here, but I suspect we will be able to start it up again at another time, very quickly.

We will keep the hearing record open for 2 weeks.

Mr. Keating has got to leave now, and Senator Dodd is on his way to start the second hearing.

Thank you, very much. We will be in touch with you all.

[Whereupon, at 10:30 a.m., the hearing was adjourned.]

STATEMENT OF HONORABLE FRANCIS A. KEATING
GENERAL COUNSEL
DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

BEFORE THE

SUBCOMMITTEE ON HOUSING AND URBAN AFFAIRS
SENATE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS
SEPTEMBER 19, 1990

Mr. Chairman and members of the Subcommittee, the Department of Housing and Urban Development appreciates your invitation to appear before the Subcommittee to discuss the Real Estate Settlement Procedures Act (RESPA). Secretary Kemp and I appreciate having this opportunity to address a number of regulatory issues that are of concern to HUD, Congress, the mortgage industry, and, most importantly, consumers.

RESPA was created in 1974 to protect the interests of consumers in federally related mortgage transactions -- virtually all transactions involving the purchase of 1- to 4-family homes -- by ensuring that consumers receive timely information on settlement costs and protecting them from unnecessarily high settlement charges. HUD is charged with the responsibility for the administration of RESPA. Of particular relevance to portions of my statement today, the Act requires, first, the disclosure to the consumer of all charges connected to the settlement, on what is known as the HUD-1 Uniform Settlement Statement. Second, the Act prohibits kickbacks for the referral of business incident to or part of a settlement service, except as compensation for actual services rendered.

Secretary Kemp has made clear over the past year his strong commitment to ensuring that HUD's programs operate for the fullest benefit of those they are intended to serve. Therefore, let me state at the outset that HUD takes very seriously its role of protecting the homebuying consumer by ensuring that RESPA regulations are vigorously enforced, and that illegal kickback and referral schemes are fully investigated and prosecuted.

However, Mr. Chairman, we do not believe that our responsibilities under RESPA prevent us from encouraging activities that guarantee to the consumer maximum availability of a range of competing products. We believe it is important to ensure that the consumer has access to information concerning the interest rates and terms offered by different financial institutions. In an era marked by widely competing mortgage products offered by national, regional and local lenders, coming down on the side of the consumer means coming down on the side of innovative ways of marketing those services.

Since the enactment of the original RESPA statute in 1974, and even since the passage of amendments to the Act in 1983, the mortgage lending market has changed significantly. It is a complex marketplace with an unprecedented proliferation of products and services; and it has become technologically sophisticated. In addition, the needs and desires of the homebuying public are undergoing continual change. It is in the context of this changing marketplace that much of the current controversy over RESPA has arisen.

I want to discuss HUD's current thinking on the issue of Computerized Loan Origination Systems, or CLOS. I also want to discuss several other pressing consumer-related issues that relate in part to the CLO issue or to HUD enforcement of the RESPA statute, namely the definition of a settlement service, referral fees, escrow accounts and controlled business arrangements.

First, let me provide the committee with a brief history of HUD's recent involvement with the regulation of RESPA.

Graham Mortgage

Since the enactment of RESPA, HUD has interpreted Section 8 of the RESPA statute to include the making of a mortgage loan as a settlement service. The Department's rationale has been grounded in part in the arguments that the act of making a Federally-related loan is central to settlement services, and that Congress originally intended to make the scope of RESPA as broad as possible to deal with the abuses then taking place in the mortgage lending business. Unfortunately, in 1984 the 6th Circuit Court of Appeals ruled in U.S. v. Graham Mortgage Corp. that, for the purposes of a criminal prosecution under RESPA, the making of a mortgage loan was not a settlement service and did not fall under the purview of RESPA. This issue has not yet been resolved by statute or regulation.

Knapp Opinion

In April 1986, in an informal legal opinion given by then General Counsel John Knapp, HUD reviewed a proposed mortgage origination program of Citicorp, now commonly referred to as Mortgage Power. The program contemplated the participation by real estate brokers, mortgage brokers and others in the Mortgage Power program; participants paid a fee for the benefit of participating in the program and gaining access for borrowers to particular loans. Under the program, borrowers paid the participants for referring them to a mortgage lender. The opinion letter first concluded that there was no RESPA violation if a realtor or mortgage broker paid a fee to participate in the program. It further stated that HUD did not object to the borrower voluntarily paying a fee to a participant in order to gain access to particular loans. The opinion issued to Citicorp also contemplated that the good faith estimate provided the buyer would contain disclosure stating that a mortgage broker fee, if any, was charged, was paid by the borrower directly to a participant, and was not required by the lender.

1988 Proposed Rule

In May of 1988, the Department published in the Federal Register a proposed rule that addressed the Graham Mortgage decision, recommended the regulatory ratification of the "borrower pay" exemption, implemented 1983 statutory changes involving the definition of "controlled business arrangements" and addressed other issues. HUD received more than 1,600 comments on the proposed rule, however no final rule has been published.

Mr. Chairman, some have raised concerns about the content of a draft final RESPA rule that was circulated within HUD in December 1988. Let me stress that unless and until HUD publishes a document stating its intentions, any comments about what the Department might or might not do on a particular issue are purely speculative. As this Committee well knows, neither published proposed rules nor internal discussions nor draft proposals effectuate public policy. Public policy is implemented only after a properly cleared document is submitted, at least in the case of HUD regulations, to Congress for prepublication review, and then published for effect in the Federal Register.

It is clear, however, that one reason for not taking final action two years ago was a concern raised by Senator Garn, in a letter dated January 3, 1989, and a similar letter from Congressman Gonzalez, that major changes in the RESPA regulations, such as those that were being considered by HUD, should be examined by the Congress.

Secretary Kemp has respected the desire of key members of the Congress that there be an opportunity for review of pertinent RESPA issues. We have used the intervening period to conduct an extended internal review of some of these critical regulatory issues. However, in keeping with our regulatory responsibilities, we are now ready to begin taking affirmative steps -- based on our evaluation of the best method of protecting the consumer and encouraging the widest possible range of choice -- to address some specific RESPA-related concerns. The Secretary has directed that we move this process forward because it is clear that failure to clarify certain regulatory issues will prevent homebuyers from realizing the benefits of this important consumer protection law. Of course, as part of this process, we welcome the input of the Congress, the public and the industry.

Mr. Chairman, the Department proposes to take the following actions:

First, we intend to act to eliminate regulatory and legal impediments created by the Graham Mortgage decision. We do not believe we can impose any regulation on CLO services without resolving this issue. Whatever we decide to do about CLOs, it is necessary to amend the RESPA regulations to define real estate settlement services in a way that includes CLOs.

Second, the Department intends to allow for the introduction or the expansion of Computerized Loan Origination Systems, subject to specific limitations and conditions and careful review.

We realize that the debate over CLOs has been centered around two diametrically opposed points of view. Secretary Kemp has tried to look at this issue from the standpoint of the potential users of the service -- the consumer. We must remember, after all, that it was for the consumer that RESPA was created. The arguments of those interests which perceive that they stand to gain or lose from one regulatory action or another must be secondary to the long-term interests of the consumers of the service. But consumer protection embraces, in the context of buying a home, a choice of financial services, the best possible interest rate and terms, and access to all the information necessary to make an informed judgment. As Secretary Kemp has stated, when viewed from the perspective of whether the consumer may ultimately gain from the service in terms of greater choice, lower rates, or both, coming down on the side of the consumer means coming down on the side of innovation.

Mr. Chairman, the Secretary does not believe that protection of the consumer from abuses requires that we insulate the consumer from the freedom to choose new products in the marketplace.

The Computerized Loan Origination System is a market-based response that has been driven by the demands of the consumer. CLOs give real estate brokers computer access to information about loans. Realtors can tell buyers what loans are available from which lenders, what the terms are, and on most systems get a good idea of whether the buyer can qualify. On one system, the realtor can qualify a buyer for a conditional loan commitment in a matter of minutes.

If technology has reached the point where loan origination and loan information can be provided by real estate brokers efficiently and economically, then it is in the interest of the homebuyer to use this service. By shutting the door on CLO systems before they have had a chance to develop, we would be denying the existence of a new technology and ensuring that consumers could never realize any of the potential benefits of a carefully regulated CLO system.

The current CLO industry is not large. The 3 largest systems are currently doing $145 million business per month, or $1.74 billion per year. That is less than one percent of mortgage originations per year nationwide. In addition, there are several small, regional CLOs. Two of the 3 largest systems merely provide rate quotes for a number of lenders. Only one, Citicorp, which does a total volume of $40 million per month, is a dedicated system. The Citicorp system provides information only about Citicorp's products, and it is capable of providing conditional loan commitments. About 30 percent of the applicants who take out Citicorp loans receive their commitment through the system.

The small size of the industry right now is not consistent with the intense concerns that have been expressed about its existence. However, we realize that the industry will grow rapidly if it is permitted to do so.

If additional CLOs are to receive HUD's permission to operate, two issues must be addressed. The first is whether the CLO system or the realtor should be required to offer more than one lender's mortgage. In other words, should dedicated systems, such as Citicorp's, be permitted? Second is whether we want to require immediate competition in the industry and how we might allow the industry to develop in ways we might not now foresee.

These are dilemmas about which many people have expressed concern; that is, whether CLOS could increase competition by increasing the number of lenders from which buyers can choose, or whether they could have the opposite effect of limiting choice by limiting the ability of small local lenders to compete. We intend to achieve the former result.

Mr. Chairman, we intend to propose that all realtors who offer computerized loan originations be required to offer the products of multiple lenders.

Under this proposal, the Department intends to assure that any system accessible from a realtor's office would display loans from competing lenders, and that a homebuyer who did not leave one particular realtor's office to obtain loan information or apply for a loan would have more than one lender from which to choose. This proposal would require that brokers offering the Citicorp service, for example, offer other lenders' services on their system within two years. In addition, Citicorp would be free to market its own system that incorporated information from other lenders.

We believe that such a system may ultimately come to resemble the computerized reservation system used today in the air travel industry. Under that system, a number of major air carriers lease their own computerized systems -- the best known systems are Apollo and Sabre -- to travel agents. Those computer systems provide the agent with information on flights available on nearly all scheduled airlines, thus allowing the consumer to make an informed choice based on the widest range of options.

Mr. Chairman, we believe that because the current CLO industry is small and concentrated geographically, a grace period is necessary to allow the development of the system we envision. The grace period would allow realtors and CLOs some growing room in those areas that are not currently served by any CLO system at present. In addition, we will require -- permanently -- that the realtor disclose to the homebuyer that he or she will receive a fee for the CLO service, and further disclose that there are other lenders, not on the CLO system, who may offer more favorable terms.

Let me assure the Subcommittee that the Secretary Kemp believes and will require that full disclosure is absolutely essential to adequate protection of the consumer's interests. We will issue regulations that will require that there be written disclosure on both the good faith estimate of settlement costs and the HUD-1 settlement statement of any fees charged to the customer for such services. Payments by borrowers to persons who assisted in bringing the borrower and lender together must be voluntary, and they must not be a condition of a loan or any other settlement service.

The Department proposes to establish a limit on fees for CLO services. We believe that the fee should be capped at a fixed dollar amount, which would be set to reflect the reasonable cost of providing such a service. Pennsylvania, for example, recently established a cap of for CLO services provided in that state, however we have not yet determined what we would consider to be an appropriate, reasonable fee for this consumer service.

Mr. Chairman, one issue raised prominently by opponents of CLO systems is the potential for conflicts of interest on the part of the real estate broker, who is, after all, an agent of the seller. We do not believe this is a legitimate concern. Mr. Chairman, by law the broker must treat the buyer fairly, provide full disclosure of material facts about property conditions, and provide the buyer good service. Although the broker, in short, is not the representative of the buyer, he has an obligation to deal with the buyer professionally and ethically. Use of a CLO is in this respect no different than a standard real estate transaction, in which the broker usually represents the seller. The key to ensuring that this process protects the consumer and allows effective enforcement is full disclosure, and to that principle the Secretary is fully committed.

Mr. Chairman, HUD's intent is to encourage competition that will provide the highest possible benefit at the lowest possible cost to the consumer. We believe there must be a fair market test of the CLO concept, and we intend to foster its development in a way that will require, not stifle, competition.

Third, the Department will propose that RESPA regulations be amended to require disclosure of a fee and the type of service provided for the fee.

Section 8 of RESPA prohibits referral fees and unearned fees. Section 8(a) prohibits giving and accepting "any fee, kickback, or thing of value" for the referral of business. Section 8(b) prohibits the giving and the acceptance of any portion of funds (for example, fee splitting) paid by the borrower of settlement services "other than for services actually performed." Consequently, RESPA Section 8 prohibits any payment pursuant to an agreement unless the party receiving the payment has actually provided goods or performed services that bear a reasonable relationship to the payment received.

Fourth, we intend to conduct a study of the practices of escrow agents. The Attorneys General of several states have complained that the standard practice of escrow agents violates the current law on how escrow amounts are to be computed. The law states that the lowest balance in the escrow account during the year cannot exceed two months' worth of the payments necessary to cover the amounts to be paid for property taxes, insurance, etc., over the year. The standard practice, referred to as "single item analysis," is to add the total amount to be paid over the year, divide by six, and set the payments to pay the total and leave this amount. The escrow amount are easy to compute by this method.

With single item analysis, the escrow amount for each item will fall to one-sixth of the required annual payments at some time during the year, after payment is made. However, all the payments are not due simultaneously for most borrowers. Rather, they are staggered throughout the year. The payments into the escrow account are the same amount each month. As a result, the actual balance in the escrow account never drops as low as one-sixth of the total yearly payments for all items. The Attorneys General argue that an "aggregate account analysis" would reveal that about two-thirds of mortgage lenders are over-escrowing by an average amount of $150.

The practice the Attorneys General are complaining about is in fact a question about the correct interpretation of RESPA. This question has not been decided, legally, although there is a HUD opinion letter saying that single item analysis is legal. Because of this, and because the practice is so widespread, we believe we should study this issue further to determine whether the current practice violates the law, and whether there is an alternative, straightforward way to compute escrow accounts that is above all fair to consumers but will not have a substantial negative effect on the amount paid for mortgage servicing. Of course, any change in escrow computations will not be implemented until we receive full comment from interested parties through publication of proposed regulations.

Fifth, we intend to address the issue of controlled business arrangements. The RESPA statute was amended in 1983 to provide guidance regarding so-called "controlled business arrangements," in which companies own or control other companies in the settlement service business. The most common controlled business arrangements are lenders who own title insurance companies, or escrow agents, although sometimes a builder will own a lender; there are also affiliations between realtors and lenders.

The 1983 statutory amendments exempt controlled business arrangements from the anti-kickback provisions of RESPA, if certain disclosure requirements are met. RESPA permits fees under a controlled business arrangement if the referred party is told of the arrangement, the referred party is not required to use the controlled entity, and no monies are passed between the referrer and the referee except for a return on ownership interest, defined as dividends or partnership distributions.

We believe that affiliations between companies involved in different aspects of a real estate transaction can, in many instances, benefit the consumer. If lenders affiliate with other settlement service providers, and incorporate the prices of these services into the interest rate on the loan, it is easier for consumers to compare the "package deal" than if they must shop separately for each service. I would add that in some states, the title insurers and escrow agents are tightly regulated, and can set monopoly prices through regulation. In those states, competition for those services can exist only if the services are part of an overall package.

Mr. Chairman, the process of real estate settlement has become a complex and in many respects bewildering business, and the opportunities for abuse are many. Secretary Kemp is committed to ensuring that HUD fulfills its obligations under the RESPA statute to ensure that this process provides the consumer with adequate information about reasonable and customary charges that are part of settlement, and protects the consumer from excessive charges and illegal activities. As I have indicated, we intend to strengthen our enforcement of RESPA's protection requirements.

We do not believe, however, that the consumer protection requirements of the RESPA statute preclude innovation in the marketplace that has the potential to benefit the consumer. We believe that Computerized Loan Origination systems, if they are developed in an orderly manner that encourages -- and indeed requires -- expanded consumer choice are one such innovation. HUD intends to let their development proceed subject to appropriate regulatory controls.

Mr. Chairman, thank you for this opportunity to testify. Secretary Kemp and I look forward to working with you to ensure that the provisions of RESPA are implemented effectively.

WRITTEN STATEMENT OF LEONARD N. DRUGER
VICE CHAIRMAN, CITICORP MORTGAGE, INC.
Before the Senate Banking's Subcommittee on Housing and Urban Affairs
September 19, 1990

Mr. Chairman. Members of the Subcommittee.

It is a privilege to appear before you today. As a leader in the mortgage business, Citicorp is at the forefront of change and innovation in our industry. Our MortgagePower program has become the industry standard, a prime example of the progress taking place. So it is in that context that I would like to discuss what is happening in our industry and how these changes benefit home buyers.

Our customers have told us that the old ways of financing a home are no longer acceptable. Customers have come to expect speed, efficiency, accuracy and convenience. So we have revamped our loan origination process in order to make it faster and more convenient for the customer. The new program, called MortgagePower, features faster loan approvals, limited documentation requirements, reduced origination costs and superior levels of service for borrowers who come to us through MortgagePower members.

Much of the consumer satisfaction and service benefits are achieved through the Realtor's role in the mortgage process. Since 1981, MortgagePower has helped to make Citicorp the largest mortgage lender in the country. Over the past nine years, Citicorp has made over $50 billion of mortgage loans to more than 450,000 consumers under the program. Our customers annually reward us with some of the highest satisfaction scores in the business. Importantly, there have been virtually no consumer complaints about the program. In addition, no one has ever brought to our attention a single consumer complaint filed against our program with HUD. The complaints we have heard are from our competitors.

The controversy comes from those competitors who would prefer to have these consumer benefits legislated out of existence rather than have to compete in the free market. It is the Realtor's role in this process that has stirred our competition. It is the competition, not the consumer, that has stirred this controversy. They would like to have the benefits of Realtor involvement in the mortgage process and the use of new computer technology at point of sale legislated out of existence rather than have to compete in the free market. Their logic is that if Realtor can be precluded from charging a fee to the consumer for these services, they won't offer the mortgage service. To create this controversy, they have suggested that Citicorp's success results from paying referral fees to realtors for loan business. Nothing could be further from the truth. Citicorp does not pay referral fees. We are adamantly opposed to such a practice. In fact, we have urged HUD to strictly enforce the anti-kickback provisions currently contained in RESPA which preclude the payments of such fees.

The real issues in this debate are whether Realtors should be permitted to assume the larger role that consumers have cast for them; whether consumers should have the right to pay for enhanced services at the point of sale from Realtors; and whether consumers have adequate protection as we move into an era of computer-based one-stop shopping for mortgages.

Let me deal with each of these issues.

Real estate agents and other intermediaries are playing a larger role in the financing transaction not because lenders have decided that they should, but because they are in the best position to provide the kind of convenience, counseling and service the consumer has demanded. Because Realtors are providing more services in response to consumer demand, a growing number of them are also beginning to charge a fee to their clients for these services.

If consumers look to their real estate agents for help to obtain a mortgage, it makes sense for lenders to facilitate the flow of information through those agents, to enable the consumer to consider their offering among the many others provided. Programs like MortgagePower have come about in response to the consumer's demand for professional counseling, fast, hassle-free processing and the convenience of computer-based mortgage services.

The role of the Realtor is still evolving, of course, thanks to technology. A growing number of Realtors are already using computerized loan origination systems which allow them faster access to loan information, do comparison shopping and give them the capability to take the customer's application and electronically transmit it to the lender of the consumer's choice.

Citicorp's MortgagePower Plus system even goes a step further. We have automated the underwriting process and can give borrowers a binding loan commitment, complete with a Truth In Lending Disclosure and Good Faith Estimate, while they are still in the Realtor's office. MortgagePower Plus runs on the same computer that the Realtor can use to access loan information on as many as 50 or more other lenders. We believe that this type of new technology will revolutionize the mortgage process and will prove to be the most efficient, cost-effective and convenient way to obtain a loan.

Realtors who have MortgagePower Plus can provide consumers with a comparative analysis of Citicorp products and pricing and match them up against the hundreds of products of other lenders by dialing into another computer loan origination system. They can match a consumer's needs with the best products and sources, assist the borrower in completing a loan submission to the lender of the consumer's choice, and work the loan through the closing process. Realtors providing this service typically do so at a cost to the consumer which is a quarter to half of that charged by independent mortgage brokers providing the same service.

The issues raised by those who would preclude the Realtor from providing this service are:

1. Conflict of Interest

We believe that there is no conflict of interest in providing separate services related to the same property. In fact, the buyer and the seller have a community of interest regarding financing the home purchase, the critical element in facilitating their mutual desires. The Realtor is the natural source for counseling on this important decision. The Realtor has no incentive or motivation to service either the seller or the buyer to the other's disadvantage. In fact, the Realtor's principal obligation is to find a ready, willing and able buyer. In today's market, able means a buyer capable of financing the purchase. The Realtor is performing two separate and distinct functions which involve no conflicts of interest. As Realtor, he acts as representative and advocate for the seller with respect to the buyer; when that engagement is substantially completed by the execution of a sales contract, he may then perform advisory services for the buyer with respect to the possible lender.

2. Adverse Steering

The consumer's interests are adequately protected as long as there is full written disclosure of any fees paid by the consumer to the Realtor for enhanced services. When the consumer contracts with the Realtor, he/she will become legally obligated to provide the best possible loan alternatives. Importantly, the Realtor receives the same mortgage brokerage fee from the consumer no matter where a loan is obtained. There is no incentive to do anything other than find the best source. This is the case with MortgagePower, as well as any other borrower-paid fee program. Most Realtors work with three or four lenders because of service, reliability and competitive rates. Our typical MortgagePower members refer less than 20 percent of their customers to us.

Importantly, computer loan origination systems have increased the consumer's choice. The same computer equipment can be used to dial into multiple systems to shop among as many as 50 lenders with hundreds of loan products. Our system is resident in many Realtor offices alongside Rennie Mae and other computer loan origination systems with multiple lenders.

It may be of interest to this committee that our customers typically shop two to four lenders and receive an average of 2.2 loan commitments before they decide which lender to go with. Clearly, consumers are looking out for their own interests and are not being steered in any single direction.

3. Double Commission

The Realtor does not charge a double commission. He/she receives a fee for the realty transaction. Any fee for mortgage services is for incremental service rendered for which the Realtor has an incremental cost. A Realtor can charge substantially less for this service because there is an efficiency in providing both the realty and mortgage service at the point of sale and spreading his/her overhead against both transactions.

In 1986, we asked HUD for an opinion on borrower-paid fees before we rolled out MortgagePower nationally. HUD's general counsel sent us a letter confirming that such fees could be paid, as long as they were fully disclosed up-front, in writing, and agreed to by the consumer. The intent of RESPA has always been to keep consumers informed and protected, not to restrict anyone's ability to charge a legitimate fee for services rendered.

The key words here are disclosure and choice.

With MortgagePower, we believe that the up-front written disclosure we require is the first step. Consumers need to know what fees are going to be charged and what services will be performed.

The second protection comes from the fact that it is the consumer who must pay the fee directly to the Realtor. The act of writing a check to the Realtor for these services is, in and of itself, the ultimate consumer protection.

As long as all fees are fully disclosed and understood, and the consumer is in control of any fees paid, Realtors should have the option to charge the customer for services rendered in the finding of a mortgage. Consumers should be able to contract for these services if they wish.

All of our competitors' arguments are predicated on the belief that the consumer needs to be protected from himself. We disagree. Our experience is that consumers are capable of watching out for their own interests, as long as there are sufficient disclosures and adequate information available to them.

We have reached the point where homebuyers can find the home they desire, electronically enter a loan applications on the spot and know whether they have a commitment for a loan before they leave the house. That is innovation. That is progress.

The mortgage industry needs to embrace innovation and use it to simplify and expedite the loan process. Instead of limiting or restricting competition, we need to focus our efforts on finding innovative ways to make housing more affordable for Americans.

We need to work together to find new and better ways to make our processes more efficient and our programs more flexible so that consumers will be able to afford their dreams.

I believe we can achieve that, but only if we put aside the kinds of industry squabbles focused on restraining competition that get in the way of real progress that will benefit consumers.

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EXHIBIT A

Release

CITICORP
MORTGAGE

FOR MORE INFORMATION:
Betsy Martin
CITICORP MORTGAGE, INC.
314-851-1441

MortgagePower Program

Fact Sheet

Name: The MortgagePower Program -- A package of superior products and services available to consumers through MortgagePower members. It offers outstanding benefits for homebuyers and real estate professionals alike.

Benefits: Loan decisions are made within 15 business days from a completed application, decreasing uncertainty on the part of the homebuyer and the amount of time it takes to close a sale.

Variety of financing options, higher loan amounts and less hassle make for a more certain commitment for the borrower. It also insures quicker sales for the Realtor.

FEATURES INCLUDE:

Priority Processing - Loan decision guaranteed in 15 business days. This efficient and reliable application process gives consumers quicker answers and less anxiety.

- more -

MortgagePower
Add 1

Simplified Process - Unlike many lenders, Citicorp requires no deposit verification. Only an in-file credit report and only pay stubs in lieu of verification of employment for loans with only 10% down.

Fast Track Processing - With as little as 20% to 25% down, no income or employment verification is needed.

- Faster decision secures sales more quickly.

Fixed Rate Loans to $1 Million - A 30-year fixed-rate mortgage for home buyers needing a jumbo loan.

No Private Mortgage Insurance - The MortgagePower Program "Stretch" feature eliminates the need for PMI.

- No additional PMI approvals needed.

Flexible Income Guidelines - Often allows borrowers who fall just outside the normal income guidelines to qualify for the home they want.

Pre-Appraisal - Listings can be "pre-appraised" to expedite the selling and commitment process.

Pre-Approval - Home buyers are offered a pre-approved loan amount commitment. They will know exactly the amount of the loan for which they qualify, contingent on finding an acceptable property. Buyers can negotiate a better sale price based upon a "cash" deal.

RelocationPower - Special services to meet the needs of relocating clients include pre-qualification so buyers know just how much house they can buy, more liberal qualifying ratios, spousal income policy which will consider up to 100% of the relocating spouse's previous income, option for a 60-day rate lock or a 90-day rate float.

No Surprises	- Problems which may arise during application process are identified early and handled quickly.
Professional Attention	- Smooth sailing, hassle-free process allows homes to close quickly.
Variety of Mortgage Plans	- Maximum purchasing power through choice of financial options to meet individual needs.
BACKGROUND:	- The MortgagePower Program is an exclusive Citicorp program in which Realtors, mortgage brokers and builders invest a membership fee for the privilege of offering specific benefits to customers and speeding home sales.
	- The MortgagePower Program has over 4,000 member firms representing more than 100,000 agents and brokers.
	- Additional benefits are added to the package regularly.
	- Members have the ability to choose the specific elements that fit their customers' needs and enhance their relationships with these customers.
	- The MortgagePower Program provides a premier level of service to members and promotes higher customer satisfaction.
	- The MortgagePower Program features may vary from state to state. Not all features may be available in every state.
	- Members are not excluded from representing any other lenders in any way.

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EXHIBIT B

MortgagePower Plus

CITICORP'S MORTGAGEPOWER PLUS

FACT SHEET

WHAT IS MORTGAGEPOWER PLUS?

MortgagePower Plus is a service enhancement to the MortgagePower program that provides consumers the:

- ° Ability to obtain an on-line (fully automated) loan commitment in as little as 15 minutes.
- ° Ability to test various loan scenarios to see what type of financing can best meet the buyer's needs. (For example, a computerized model can help the buyer determine if a 30-year, fixed-rate loan is more advantageous than a 15-year, fixed-rate loan, or a one-year ARM, etc., based on current interest rates.)
- ° Ability to pre-qualify for a loan through Citicorp.
- ° Ability to immediately access loan status information.

AVAILABILITY:

Currently available only through Citicorp's test markets. National availability planned by 1991.

BENEFITS:

- ° Faster loan processing for consumer which can increase negotiating certainty for both buyer and seller.
- ° Prevents consumer from waiting 30 days (current average turnaround time for the industry) to get a decision on the loan. This eliminates consumers' anxiety in waiting, the uncertainty of not knowing whether or not the home is theirs, and the inability to continue with moving plans.

CITICORP MORTGAGE

° Enables consumers to compare various Citicorp loan options by giving them up-to-the-minute pricing on various types of loans.

LOAN PURPOSE:	Purchase money, first mortgage loan.
OCCUPANCY STATUS:	Primary residence only. (No second homes or investment property.)
PROPERTY TYPE:	° Residential (1-4 Family). ° Approved Condominiums. ° Residence Under Construction (provided the land is being purchased).
BORROWER:	° 1-4 borrowers (joint owners must all reside in the home.) ° individuals only.
AMOUNT FINANCED:	Minimum: $ 25,000 Maximum: $500,000 Loan to value: Up to 90 percent of sale price.
PRODUCTS AVAILABLE:	° 6-Month ARM ° 1-Year ARM ° 3-Year ARM ° 15-Year Fixed-Rate Loan ° 30-Year Fixed-Rate Loan

# # #

EXHIBIT C

CUSTOMER AGENCY AND FEE AGREEMENT

(FOR HOME FINANCING)

TO: ____________________________________ DATE: ____________________________

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(MortgagePower® Member)

You have advised me that you are authorized and prepared to provide me assistance in securing home financing. I understand that your services may include, but are not limited to (1) counseling on available home financing products; (2) counseling on our debt service and financing capability; (3) assistance in completing loan applications; (4) additional assistance in processing loan applications; and (5) meeting any conditions of loan commitment.

I also understand that you are a member of Citicorp Mortgage, Inc.'s MortgagePower® Program and as such your customers are entitled to certain benefits not generally available to the general public. In order to participate in the MortgagePower Program, you have paid an annual fee. I understand that you are not required to refer me to Citicorp Mortgage, Inc. ("CMI") or any other lender, nor shall I be required to seek financing through CMI or any other lender.

I would like to engage you as my agent for the purpose of advising me about home financing and to provide the services described above. This agency will continue until the earlier of the declination of my loan request(s) or the closing of my loan. I acknowledge that you cannot commit any lender to provide financing or otherwise act on its behalf and that your services are purely advisory and administrative in nature.

I understand and agree that, as compensation for your home financing services, I will pay you ______________% of the loan amount or $ __________. If the loan amount changes and a percentage is specified, the fee will be based on that percentage of the final loan amount. I further acknowledge that this fee will be paid directly to you and is not imposed by or paid to the lender.

I understand that, under applicable federal law, the above fee will be considered part of the cost of obtaining home financing and will be disclosed to me by the lender as part of the finance charge for such financing. You may, if required by lender, forward a copy of this agreement to any lender to whom I apply for a loan.

Please check one of the boxes below:

☐ CMI may communicate directly with you concerning certain aspects of my loan, to include forwarding any commitment letter and other loan documents and disclosures directly to you.

☐ CMI may not communicate directly with you concerning certain aspects of my loan, to include forwarding any commitment letter and other loan documents and disclosures directly to you.

Mortgage Life Insurance (Where offered by MortgagePower Member)

You have advised me that mortgage life insurance is optional and that if I purchase it I may choose my own provider. To request this coverage I must complete the application for Mortgage Protection. I understand that if I purchase this insurance at the estimated premium which is disclosed on the insurance application (the actual premium will be based on the actual loan amount), that Family Guardian Life Insurance Company, which is a subsidiary of CMI, will issue the insurance (except in the states of NH, PA and RI, where the insurance will be issued by AIG Life Insurance Company, and reinsured by Family Guardian). I further understand that the insurance company pays a commission to its licensed agents under this program up to 35% of the first year's premium or pays a service fee to MortgagePower Members for administrative services provided and that any payment by the insurance company does not increase my premium.

Agreed and Accepted:

____
Signature of Loan Applicant

____
Signature of MortgagePower Member

____
Signature of Loan Applicant

EXHIBIT D

Disclosure Regarding Mortgage Advisory Services

To the Seller

You have entered into a Listing Agreement with

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to act as your agent for the sale of your property. As your agent, we owe to you a duty of undivided loyalty in any transaction relating to this property. We have two essential obligations to you (1) to obtain the highest possible price, given market conditions, for the property and (2) to procure a ready willing and able buyer.

In order to faithfully pursue these obligations to you, we may, with your consent, provide certain financial advisory services for prospective purchasers for a fee payable by that person(s). This fee is entirely separate from any sales commission payable by you and will not reduce or increase the amount of that commission.

Since most home buyers seek financing for the purchase it may be advantageous to determine whether the prospective purchaser is qualified to obtain financing and to assist in obtaining such financing. By providing this additional service to the buyer, we believe we can more effectively meet our obligations to you as your agent. If you agree to permit us to provide such services, our agreement with the buyer will be substantially in the form of the Agency and Fee agreement attached to this disclosure form. Neither the closing of the loan nor the sale of your property will be contingent upon receipt of any fee owed us by the buyer.

____

By:
Licensed Real Estate Agent

Acknowledgment of Seller

I have read and considered the above disclosure. I will permit/will not permit you to provide a prospective purchaser the services described in this disclosure and the attachment.

____

(See Reverse Side)

STATEMENT OF THE PRUDENTIAL REAL ESTATE AFFILIATES, INC.

ON THE

REAL ESTATE SETTLEMENT PROCEDURES ACT

PRESENTED TO THE HOUSING AND URBAN AFFAIRS SUBCOMMITTEE

OF THE

SENATE BANKING, HOUSING AND URBAN AFFAIRS COMMITTEE

September 19, 1990

INTRODUCTION

The Prudential Real Estate Affiliates, Inc. ("PREA") commenced the business of franchising residential real estate brokerage offices in early 1988. At the present time it has over 900 offices across the United States with its headquarters in Costa Mesa, California. In establishing this franchise system, PREA had the opportunity to implement a number of new concepts with the objective of providing services to its franchisees which would put them in the forefront of the real estate brokerage industry. The key to this evolutionary step in real estate brokerage was to develop computerized systems for the enhancement of real estate brokerage offices.

The computerization of the PREA franchise system included several software modules one of which was a computerized loan origination system known as CLOS. The CLOS system is one of the principal reasons why there is a confrontation between real estate brokers and mortgage bankers which has resulted in the current Congressional hearings.

This controversy is framed in the context of the Real Estate Settlement Procedures Act, 12 U.S.C. sections 2601 et. seq. ("RESPA"). The issue is whether or not compensation to real estate brokers for the operation of such systems is a referral fee. What is really occurring is a confrontation between two segments of the real estate industry resulting from a technological development which is causing a restructuring of traditional functions. Specifically, mortgage origination functions heretofore performed by mortgage bankers and mortgage brokers can now be performed more efficiently by real estate brokers through the use of computerized systems. In performing these services real estate brokers incur costs which gives rise to their need to receive reasonable compensation within the scope of RESPA.

RESPA BACKGROUND

RESPA was enacted in 1974 to remedy a variety of practices in the real estate settlement process which were deemed to be detrimental to the consumer. Many participants in the industry claim responsibility for enactment of the statute including the Mortgage Bankers Association ("MBA") and the American Land Title Association ("ALTA"). A concern of these associations was to establish a statutory basis to prohibit the further payment of referral fees to real estate brokers for mortgage, title and other settlement service business.

It is interesting to note that there is a substantial question as to whether mortgage services are within the scope of the statute. RESPA specifically identifies several settlement services yet there is no reference to mortgage services, notwithstanding their integral role in completion of the real estate transaction. There have been two federal court decisions which have found that mortgage services are not included within RESPA; however, the primary decision, U.S. vs. Graham Mortgage Corporation 740 [illegible]d 414, 419 (Sixth Circuit 1984) was a criminal case which necessarily required a narrow interpretation of the statute.

RESPA imposes two major obligations on particular parties in residential real estate transactions in which there is a federally related mortgage. The first is the requirement to disclose all charges incident to the settlement of the covered transaction on a specified form, the HUD 1 Uniform Settlement Statement. The second is to prohibit the payment or receipt of referral fees or kickbacks or any splitting or sharing of the charges with respect to settlement services involved in virtually all residential real estate transactions.

The operative provisions of RESPA which prohibit the payment of referral fees are set forth at 12 U.S.C. Section 2607, commonly referred to as section 8. RESPA by its own terms provides a major exception to the referral fee prohibitions by permitting payments to any person of a bonafide salary or compensation or other payment for goods or facilities actually furnished or for services actually performed.

Over the past sixteen years, the predominant questions in applying RESPA to the real estate brokerage industry have been what is a referral fee and, to a lesser degree, what constitutes a referral. The RESPA regulations issued by HUD after adoption of this statute gave some initial guidance as to what constituted a referral fee. However, HUD has chosen not to limit its jurisdiction by delineating what is and is not a referral.

The real estate industry involves complicated relationships with many practical variations which are not addressed in or go well beyond the scope of existing regulations. This has resulted in HUD issuing informal opinions which constitute a non-binding commentary by HUD on whether proposed business methods appear to be in violation of RESPA. Predominant attention in these opinions has been given to the referral fee provisions of section 8.

In 1983 a controversy arose which was similar to the current situation. In that instance the ALTA sought to block real estate brokers from owning title agencies on the basis that such arrangements violated the referral fee prohibition of RESPA. In rejecting the ALTA's contentions, Congress adopted the controlled business provisions of RESPA clarifying that real estate brokers could refer business to settlement service companies in which they had an ownership interest. Disclosure requirements were adopted as well as a limitation that the only gain from the referral of such business be a return on the real estate broker's ownership interest in the settlement service company i.e a dividend rather than referral payments.

With reference to mortgage services, there have been two important positions taken by HUD which have shaped the controversy which exists today with respect to real estate brokers being compensated for mortgage origination services. Initially, Citicorp obtained an informal opinion from HUD which essentially stated that payments by borrowers to real estate brokers for mortgage counseling services were not within the scope of RESPA. This was based on HUD's conclusion that the statute was not intended to reach voluntary payments by consumers to settlement service providers; rather, only payments by settlement service providers were within the scope of the statute.

A follow up to this position was a subsequent opinion issued by HUD to American Financial Network. This effectively reaffirmed the Citicorp opinion in recognizing that borrower payments to real estate brokers operating the American Financial Network computerized loan system were not subject to regulation under RESPA.

These opinions were ominous statements that caused concern within the mortgage banking industry. The MBA contended that payments by borrowers to real estate brokers for mortgage services were an indirect method for the payment of a referral fee by the lender to the real estate broker. Nevertheless, the threat to the traditional mortgage market from borrower pay arrangements was limited. Hence, there was mild controversy between the mortgage bankers and some real estate brokers but no significant conflict.

The second major development which escalated the controversy between the mortgage bankers and the real estate brokers was the HUD opinion obtained by PREA on October 3, 1988. In that opinion HUD made a direct statement on compensation to real estate brokers for computerized loan origination services with respect to arrangements which it felt were within the scope of RESPA. HUD affirmatively stated that real estate brokers as well as providers of computerized loan origination systems could receive payments which were subject to RESPA as long as the amounts paid were reasonable compensation for services rendered and facilities provided.

As more particularly discussed hereinafter, PREA's system, CLOS, has payments being made by lenders on the system to PREA as the system provider, with a portion of such payments being paid by PREA to its franchisees for completed loan applications on the system. A copy of this opinion is attached hereto as Exhibit A.

The PREA opinion was regarded by mortgage bankers as a direct threat to their traditional methods of business. It implicitly sanctioned payments to real estate brokers by other institutional participants in the real estate industry, which includes lenders, for mortgage origination services. This was a significant step beyond the earlier statements by HUD that borrowers could make payments to real estate brokers for such services.

Upon issuance of the PREA opinion by HUD, the MBA launched a campaign to halt this trend. It lobbied HUD to change its position through new regulations which were being considered for RESPA; it requested that Congress amend RESPA to specifically preclude such payments; and, it proceeded at the state level to prohibit that which is now specifically permitted at the federal level.

In the spring of 1988 HUD had proposed revised RESPA regulations for public comment. That draft concentrated primarily on the issue of controlled business i.e. payments for settlement services performed by related companies. It gave little attention to broker compensation for mortgage services other than ratifying the Citicorp position. After the October letter from HUD regarding the CLOS system, there was extensive activity by the MBA to have HUD reverse this position through a second draft of revised regulations.

There was an internal draft of regulations circulated within HUD in December 1988 which in concept proposed a reversal of HUD's position. It should be noted that this aspect of the regulations would have been invalid as the services rendered exception to Section 8 can not be changed by regulation to exclude real estate brokers from receiving reasonable compensation for any settlement services including mortgage origination. This draft was not, however, adopted by HUD nor was it ever issued to the public. There were requests by members of Congress that HUD not take any further action on the issue until such time as it could be considered at the Congressional level.

In January 1989, the Bush administration took office and there were several departmental changes at HUD. The controversy of compensating real estate brokers for mortgage origination services was brought to the attention of the new personnel at HUD. There have been no further actions of significance on this subject although HUD has effectively reaffirmed its prior positions by allowing the status quo to remain. Hence, the necessity from the MBA's point of view to press for a Congressional review of the issue.

THE CLOS SYSTEM

In order to evaluate the arguments concerning the compensation of real estate brokers for operating computerized loan origination systems, one must understand how these systems work. PREA believes that CLOS is an ideal example of such a system.

CLOS essentially serves as a method for lenders on the system to market and originate mortgage products at the real estate sales offices of the PREA franchisees. It is an efficient alternative to the traditional methods used by the lenders in which mortgage brokers and loan solicitors are the source of mortgage originations.

CLOS is designed to have on it approximately six to eight lenders that operate on a nationwide basis and three to four regional lenders in various areas around the country. The exact number of lenders on the system will fluctuate. Nationwide lenders are selected on the basis of their ability to offer a wide variety of competitive loan programs and reputation for service. Regionally, PREA's franchisees recommend lenders that they prefer. This method of selection plus PREA's desire to monitor the consistency of lender service results in the system not being available to all lenders. There also are technical limitations on the number of lenders that can participate on the system so that it can function with reasonable speed for the user. The system makes available a variety of mortgage loan programs including, but not limited to conventional loans, adjustable rate mortgages, and mortgages with different periods of maturity.

CLOS is first utilized by prospective homebuyers at the real estate broker's office to determine their buying power in light of current pricing and underwriting criteria for the mortgage products available on the system. By doing the prequalification, the homebuyer and real estate salesperson are accurately informed of the loan amount and type of loan that the homebuyer is qualified to obtain.

After a home is selected and a purchase contract entered into, the prospective borrower utilizes CLOS to select a specific loan product and make initial application for it by means of the system. The information, if any, previously entered into the system with respect to that prospective borrower, forms a basis to do the more precise selection of the appropriate loan.

CLOS performs an unbiased presentation of loans based on a "Best Fit" analysis. After determining the type of loan desired, the prospective borrower then indicates primary and secondary preferences for distinguishing among the loan products available with that program type. For example, the primary criteria may be the lowest monthly payment amount or the lowest closing costs. When the first of these items is selected, it becomes the primary criteria for distinguishing and ordering the presentation of loan products available. The second choice criteria also provides a further basis for distinguishing and ordering those loans that have no difference in the primary characteristic such as the same monthly payment.

The loan products are then displayed on the system in order of priority as to meeting the criteria designated. The prospective borrower may, of course, alter the criteria to obtain different presentations of the respective products. Any of the loan products displayed under the "Best Fit" analysis may be reviewed in greater detail on the system.

An employee of the real estate broker, the systems administrator usually becomes involved at this stage. PREA is testing the use of a financial specialist as a more sophisticated person to assist the homebuyer.

The system also includes a short form loan application function which provides the basis for the lender to commence processing the loan request. Upon completion of the short form application process, a telephone call is placed to the lender notifying it of the prospective borrower.

The lender will upon request give a rate and fee lock in based on the representation of the franchisee that the prospective borrower has completed a written application. The written application is sent directly to the lender so that it may immediately continue the loan approval process.

The lender deals directly with the prospective borrower thereafter, PREA requests that the lenders communicate with the prospective borrowers on a weekly basis to notify them of the status of their loan applications. In the same regard, there are informational updates, using a detailed checklist, provided by the lender on the system to the respective franchisees with regards to the progress of the pending mortgage transactions.

The lenders on the CLOS system pay PREA a services rendered fee of $425 per application, although the HUD opinion was based on $500 per application. In support of this compensation, PREA has made significant expenditures in developing CLOS and incurs substantial ongoing costs in maintaining, updating, and administering the system.

The franchisees receive a flat fee of $100 from PREA for each bonafide application generated by them on the system. The franchisees incur direct overhead expense in maintaining employed personnel to operate the system. These are costs which would not otherwise be incurred by the franchisees as real estate brokers. It should be noted that $100 per application to the franchisees has proven to be too low even from a cost reimbursement point of view.

THE PROVIDING OF CLOS SERVICES BY REAL ESTATE BROKERS IS NOT A REFERRAL

The cornerstone of the MBA's position is that the providing of computerized loan origination services by real estate brokers is merely a referral arrangement between the real estate broker and the lenders on the system. This position fails to recognize the added services being provided by real estate brokers operating systems such as CLOS and the costs incurred by them in rendering these services.

It has been inaccurately asserted that real estate brokers have always provided these services without the use of a computer. However, real estate brokers traditionally have not provided these services as they usually referred buyers to mortgage bankers or mortgage brokers.

Real estate brokers, particularly at the resale level which is the majority of transactions, traditionally did not take loan or credit applications. It is simply a myth to assert that real estate brokers were always performing services for lenders by taking applications for mortgages.

Certainly real estate brokers have always done some prequalification work with homebuyers; however, this has not involved the use of computers which do precise prequalifications based on current pricing and underwriting criteria such as done by the CLOS system. Beyond that, functions such as the "Best Fit" analysis under the CLOS system could not be performed by real estate brokers until the introduction of new technology and sophisticated software.

Until recently the means to provide computerized mortgage services at the real estate broker's office was not available. The presence of systems such as CLOS now enable real estate brokers to provide an enhanced version of the services that have ostensibly been provided by mortgage bankers or mortgage brokers up through the point of the mortgage application.

The review of lenders, loan products and loan characteristics in light of current market information, followed by the loan application process, are important functions in the real estate transaction which are totally distinct from those of real estate brokerage. The fact that they are now being performed by another participant in the real estate transaction, the real estate broker, does not mean that these services are merely a referral.

The mortgage bankers in asserting that services such as CLOS are only a referral cast severe doubt on the traditional functions of mortgage brokers. If providing assistance to the homebuyer with a computerized loan origination system and the preparation of a full or short form application is of no value, then upon what basis are payments made by mortgage bankers to mortgage brokers for the same or lesser services? It is incontestable that mortgage brokers in many cases perform no additional functions beyond the application stage. Mortgage brokers are often not involved in the underwriting process, loan documentation, and loan funding which follows the application stage.

Nevertheless, it is commonplace for mortgage bankers to pay mortgage brokers or for mortgage brokers to charge the borrower up to 100 basis points for having obtained the borrower, selected the mortgage product and prepared the loan application. In the case of CLOS, the total compensation currently being received by PREA is $425 per loan from which $100 per application, usually 10 basis points, is paid to the real estate broker for their services.

Compensation under borrower pay systems are at the level of approximately 50 basis points. This is paid by the borrower and is shared by the system provider and the real estate broker operating such systems. Again, this amount of compensation is less than the amount that is normally paid to mortgage brokers for similar services.

CLOS and at least one of the major borrower pay systems rely upon a compensated person being present in the real estate office to do the mortgage broker type of function. They review loan products and do the credit application process with the borrower after the real estate contract has been signed by the buyer and seller. In the case of CLOS, the systems administrator who is an employee of the real estate broker works with the homebuyer. The added presence of such persons working with the buyer and the computerized system is further reason why a mere referral is not occurring between the real estate broker's office and the lenders on such systems.

HUD stated in its informal opinion to PREA that the compensation arrangements proposed for CLOS were in compliance with RESPA. It did not believe that this was an arrangement for the payment of referral fees. This determination was based on the fact that real estate brokers as well as any other service providers are entitled to receive the reasonable value of their services rendered and facilities provided.

The underlying basis for this conclusion as to the real estate brokers was that they were performing services and incurring costs beyond those which are normally attributable to them in the real estate transaction. Accordingly, real estate brokers were found to be entitled to receive reasonable compensation for these services.

The National Association of Realtors, PREA, and other parties interested in this issue all agree that the payment of referral fees should remain prohibited. Nevertheless, it is fallacious to characterize computerized loan origination systems as merely a referral arrangement.

CLOS SERVICES DO NOT INCREASE COSTS TO THE CONSUMER

There are two aspects of a consumer cost analysis when considering computerized loan origination services. The direct inquiry is whether the consumer in using such a system is paying any more in obtaining a mortgage. The indirect approach is whether the lender is incurring additional costs which are in some manner passed on to the consumer.

In establishing CLOS, PREA has determined that there should be no added costs to the consumer or the lender through their participation with the CLOS system. It should be recognized that CLOS is not a borrower pay system. There are no payments made by the borrower to the real estate broker or the system provider for the CLOS services.

Secondly, a basic operating premise of PREA with the lenders on CLOS is that the origination costs, including interest rates and loan points, paid by the borrower to the lender are to be no higher for a loan originated through CLOS than for the same loan obtained outside the system. Hence, there is to be no change in the lender's pricing by virtue of the fact that a loan is originated from the CLOS system.

The cost to lenders on CLOS to obtain an application from the system are no more and often less than their cost for applications from traditional sources. Loan applications from mortgage brokers which result in closed loans frequently cost the lender directly or indirectly one point. In-house costs to lenders that use mortgage solicitors to obtain applications are in the range of 50 to 75 basis points. Contrast this to the $425 fee (on the average being 42 basis points) that it costs the lenders on CLOS to obtain an application from that system.

Obviously the lenders on CLOS have no mortgage brokerage costs because the applications come directly from the real estate broker. Additionally the lenders on CLOS have committed to not send their mortgage solicitors to the PREA franchisees to avoid duplication of marketing efforts at those offices. As a result of the foregoing there is no economic reason for such lenders to seek higher loan costs directly or indirectly from homebuyers participating on CLOS.

With regards to borrower pay systems, lenders generally reduce their loan points to the extent of the payment being made by the borrower for the services of the loan system and real estate broker's operation thereof. This is the same pricing method that lenders often use with mortgage brokers. Accordingly, the consumer should not be paying more for loans derived from such systems.

The presence of multiple lenders on computerized systems and in particular the unbiased selection of loans on the CLOS system creates added competition. Lenders that retain higher rates and charges will not have their loans selected by the system and displayed as the best priced products for borrowers.

The prolification of such systems should be encouraged to expand this competitive environment. Stifling this trend through efforts to prevent real estate brokers from receiving reasonable compensation for these services is contrary to this goal.

CLOS ADDS EFFICIENCY TO THE REAL ESTATE INDUSTRY

The emergence of CLOS is a significant improvement in the real estate transaction. Not only are these services a more efficient method for mortgage bankers to originate loans but they are also an added tool which enable the consumer to make an informed selection of the mortgage.

Homebuyers up to now have had to rely primarily upon the real estate broker for referral to a lender. This has been a structural weakness in the overall transaction in view of the fact that homebuyers have not shopped for mortgages in the way that they shop to find a home. It may be fair to state that homebuyers today are often aware of the prevailing interest rates; however, this does little to assist them in actually selecting a lender because most lenders ostensibly charge similar rates. Systems such as CLOS provide the homebuyer with the information to participate meaningfully in the mortgage and lender selection process.

The presence of this tool at the real estate broker's office is of further importance in that it provides an immediate basis for the homebuyer to proceed with obtaining a mortgage. This is an improvement to the prevalent scenario where the homebuyer completes the contract of purchase, leaves the real estate broker's office, and spends several days contacting lenders that have been recommended by the real estate broker.

Mortgage bankers have been losing money for years on the origination of mortgages. As illustrated on Exhibit B attached hereto, the average loss on origination, (through closing) is $1,244.00. This loss has been increasing for the past several years. This trend compels the industry to seek greater efficiency at all stages of the mortgage origination process.

Many mortgage bankers have chosen to withdraw from the retail end of the business and purchase loans which are in the process of being or have just been funded. Others have chosen to originate mortgage from systems such as CLOS. A computerized loan origination system is an attractive alternative to the costs of in-house production of business through mortgage solicitors or obtaining business from mortgage brokers. Furthermore, utilizing such systems is more efficient in having other parties, the system provider and the real estate broker, bear the overhead costs attributable to obtaining loans.

From a structural point of view, the functions of loan origination through application can now be performed by different parties in the real estate transaction. The computer system provider and the real estate broker are taking on responsibilities that were traditionally those of the mortgage banker or the mortgage broker. Certainly, there is no reason why this shifting of functions should be impeded legislatively at the federal or state level.

The real estate broker is a natural point of sale for services related to the real estate transaction such as mortgage, title or escrow. The providing of multiple services by a single source could lead to packaged pricing. The consumer may pay less for these services on a combined basis, which might include the real estate brokerage commission, as compared to payment for these services individually.

The mortgage banking industry should take a positive approach to this technological development. Mortgage brokers in particular should duplicate such systems so that they can be promoted to the public directly or through real estate broker offices. Regional and local lenders can also form similar systems for the presentation of mortgage information to the home buying public. It is simply short sighted for anyone to attempt to block technological progress through legislation.

THERE IS NO CONFLICT OF INTEREST IN REAL ESTATE BROKERS PROVIDING MORTGAGE SERVICES

Assertions that there is a conflict of interest in real estate brokers providing mortgage origination services to home buyers exhibit a lack of understanding of the real estate brokerage process and the responsibilities involved. Initially, it is entirely consistent with the interests of the seller for the real estate broker to assist the buyer in completing the transaction. PREA encourages its franchisees to promote CLOS as an additional service to encourage sellers to list their homes. CLOS is presented as an additional capability of the franchisee to assist the future purchaser of the seller's home in completing the transaction.

Under traditional real estate broker relationships the primary obligation of the real estate broker is to bring a ready, willing, and able buyer to the seller. Mortgage prequalification of a prospective buyer on a CLOS system is certainly consistent with determining what the buyer is able to purchase.

Once a real estate contract has been entered into by the parties the real estate broker generally is not required to take further affirmative steps towards completion of the transaction. However, from a practical point of view, the commission is usually not earned until the transaction closes. Increasing capabilities which result in providing further assistance to the homebuyer, such as computerized loan origination services, merely improve the chances of the real estate transaction being completed to the satisfaction of all parties involved.

Disclosure to the seller by the real estate broker of added capabilities such as having CLOS in the broker's office would, in any event, negate theoretical agency conflict issues.

In the past few years the courts as well as the legislatures in over 21 states have recognized that the real estate broker, particularly one dealing directly with the buyer, may be an agent for both parties. This has led to legislation establishing disclosure procedures in many states whereby the real estate broker and the parties involved acknowledge whether each real estate broker is the seller's agent alone, a dual agent, or the buyer's agent.

In the instance of a dual agency or buyer's agency there is no possible inconsistency in providing mortgage origination services to a homebuyer. Furthermore, as previously noted it is simply illogical to contend that the real estate broker which represents the seller only, by direct agency or sub-agency, has a conflict in providing mortgage assistance to the homebuyer.

It has also been asserted that a conflict of interest arises because the real estate broker is receiving compensation for mortgage origination services from the lenders on the computerized loan origination system. Hence, it is concluded that such real estate brokers steer homebuyers to lenders on these systems in order to obtain compensation.

Notwithstanding the assumption that services rendered compensation to the real estate broker is an added incentive for steering, the facts do not support this conclusion. PREA's franchisees have used CLOS modestly, with the vast majority of the mortgage business going elsewhere. The experience of major real estate brokers with respect to related ancillary services has been the same.

The steering argument also ignores the added role that the consumer is able to play by virtue of the computerized loan origination system being present in the transaction. CLOS is an ideal example in that the homebuyer is given a wide selection of loan products and is able to request that the system do an unbiased selection of those products based upon the homebuyer's criteria. At the point where the homebuyer is reviewing loan products as well as lenders the chances of steering are diminished, if not eliminated. Additionally, the amount of net compensation to the real estate broker's office after its expenses for being on the system is de minimus and not a factor that will influence the direction of mortgage business. Little if any of this compensation finds its way to the actual real estate salesperson that suggests the use of CLOS by the homebuyer.

Compare this to the competitive environment which exists in the absence of such systems. Real estate brokers recommend mortgage bankers or mortgage brokers to homebuyers for a variety of reasons which in most instances would be considered arbitrary as opposed to the precise display of information on computerized systems. The homebuyer is then in the position of dealing with a mortgage banker whose sole interest is the providing of its own mortgage products without reference to or comparison with those of competing companies. Mortgage brokers pose a similar situation in having there sole compensation dependant upon the homebuyer obtaining a mortgage from the specific lenders which they represent.

Computerized loan origination systems are a significant step forward in giving the consumer a sophisticated review of mortgage products and lenders in a non-lender environment. The homebuyer can then proceed in any direction desired based upon a comparative analysis of lenders and their products.

CONCLUSION

The real estate industry with respect to mortgage services is clearly proceeding through a period of structural change. The development of new computer technology has now involved the real estate broker in the mortgage process. This trend in the long run is irreversible. Furthermore, there will inevitably be further structural changes in the real estate industry. These will include the vertical integration of ancillary settlement service companies which will add further efficiencies to the real estate process.

RESPA is adequate in its current form to address the legality of payments among settlement service providers in light of these changing circumstances. The fundamental concept to be applied is that the payment of reasonable value for services rendered and facilities provided is permissible.

Many variations in business methods will continue to develop among the settlement services including mortgage. RESPA would have to be under constant amendment to address each possible business arrangement. It is best to allow HUD to consider individual methods of business upon their merits and enforce the statute in light of the basic principles stated therein. Furthermore, recourse exists at the judicial level to determine whether or not particular arrangements circumvent the referral fee prohibitions of RESPA.

PREA is confident that the compensation method under CLOS is not a referral fee arrangement in any respect, particularly as to the activities of the real estate brokers involved. HUD also did not believe that this was the case and many mortgage bankers concur.

Several years ago a similar controversy arose between the American Land Title Association and the real estate brokers with respect to real estate broker owned title agencies. The issue then was also whether the business arrangement violated the referral fee prohibitions of RESPA. The efforts of the title industry to block real estate broker involvement in that business were rejected by Congress and controlled business provisions based on disclosure were adopted as amendments to RESPA.

In view of the fact that Congress allowed real estate brokers to recommend the use of settlement service providers related to them in ownership, it would be inconsistent for Congress to now conclude that real estate brokers cannot be reasonably compensated for directly providing a portion of one of these services, mortgage origination, in real estate transactions.

There has been an over reaction to a technological development which is still in its early stages. Efforts to stifle this development through a legislative ban on services rendered compensation to real estate brokers using this technology is protectionist and unwarranted. PREA submits that CLOS and other computerized loan origination systems should not be prevented from competing in the mortgage origination market place.

U.S. ARTMENT OF HOUSING AND URBAN DEVE MENT
WASHINGTON, D.C. 20410-0500

OFFICE OF THE GENERAL COUNSEL

OCT 3 1988

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Stanley M. Gordon, Esquire
Gordon and Drysdale
610 Newport Center Drive
Suite 700
Newport Beach, CA 92660

Dear Mr. Gordon:

This is in response to your letter dated July 18, 1988 in which you requested an opinion whether a particular arrangement is consonant with the Real Estate Settlement Procedures Act (RESPA) (12 U.S.C. §2601 et seq.) or the RESPA regulations (Regulation X) at 24 CFR Part 3500. HUD's longstanding position that the making of a mortgage loan is a settlement service is restated in 53 FR 17428, Column 3, May 16, 1988 (the proposed Regulation X revision). We conclude that we have jurisdiction over matters raised by your question.

Your July 18, 1988 letter states that The Prudential Real Estate Affiliates, Inc. ("Prudential"), a subsidiary of The Prudential Insurance Company of America, has recently commenced operating as a franchisor of real estate brokerage franchisees nationwide. These franchisees will be independently owned and operated businesses principally engaged in residential real estate activity. A computerized loan origination (CLO) system will be an integral part of the franchise relationship.

The CLO system will be a mechanism for lenders to bring their mortgage products to prospective homebuyers in the sales offices of the franchisees. It is anticipated that the system will typically include as many as six national lenders and three regional lenders per area and will make available a variety of mortgage loan programs. Prospective homebuyers will first be able to use the system to determine which type of loan is most suited to their financial situation (a pre-qualification function). The system will also include a loan application function which will enable the prospective homebuyer to actually generate a loan application, and the system will produce a Regulation X Good Faith Estimate, the Regulation Z Truth in Lending disclosure forms, and, if necessary, a Regulation X controlled business arrangement disclosure form.

Upon completion of the loan application, a communication (currently expected to be a telephone call) will be directed to

EXHIBIT A

the lender notifying it of the prospective borrower. The lender will give a preliminary commitment based on the representation by the franchisee that the prospective borrower has generated an approvable application through the system. The CLO system will then directly transmit the application to the lender; a signed application will be dispatched to the lender soon thereafter. The lender will deal directly with the prospective borrower from this point.

The lenders included in the system will pay Prudential, the franchisor, a fee in the range of $450 to $500 per loan application. Prudential will give lenders a credit for those applications which are subsequently denied by the lender or cancelled by the prospective borrower. The flat fees paid to Prudential by each lender are intended to be for the reasonable value of the services rendered and facilities provided related to the CLO system. Franchisees will receive a flat fee from Prudential, not to exceed $100, for each application generated by them on the system as recompense for operator time and expense in pre-qualification and qualification activities. Franchisees will retain a fulltime employee to perform these activities. Prudential will exercise its interior quality control in concert with respective lenders to determine whether applications that are frivolous, incomplete, or otherwise not acceptable for the lender for further processing are being placed in the system. The intent of the payment to the real estate brokerage franchisees is to reimburse costs of services rendered and expenses incurred in operating the computerized loan origination system and dealing with homebuyers. No fees between lenders and franchisees or between franchisees and borrowers are contemplated.

Fees proposed to be paid by lenders to Prudential, the franchisor, and to real estate brokerage franchisees appear to be fees similar in character to fees for "goods or facilities actually furnished" under Section 8(c)(2) of RESPA. In reviewing an analogous arrangement of the Ohio Association of Realtors REAL-FIND program in an October 9, 1984 letter (enclosed), then General Counsel John J. Knapp concluded that while payment for computer time and usage did not fit neatly into the language of Section 8(c)(2), describing "goods or facilities actually furnished", HUD had the general authority to exclude payments which did not appear to be disguised kickbacks or referral fees. He concluded that a $200-$250 payment for computer time was not barred by Section 8. In the program presented here, the payments are for the computer software/hardware system, system upgrading and administration by the franchisor, and system operation by the franchisees. Under this program the prospective borrower is placed in a position to choose an appropriate mortgage loan program and initiate the loan application process from the offices of the real estate brokerage franchisees. Based on the rationale in the October 9, 1984 Knapp letter, we conclude that these payments are not barred by Section 8, so long as there is a reasonable relationship between costs incurred and fees paid. This is particularly important in the case of the fee paid to franchisees; the flat fee for applications generated should not be excessive so as to constitute a disguised referral fee.

The Department has published proposed rules in the Federal Register on May 16, 1988 (53 FR 17424). While your program as described does not appear to violate the principles set forth in the proposed rule, you should be aware that no commitment can be made to the content of the final rule and it could have an adverse impact on your program. Also, we have not considered in this opinion whether the arrangement would be permissible under FHA guidelines.

This opinion represents an unofficial staff interpretation. Reliance on an unofficial staff interpretation does not provide protection from liability under Section 3500.4.

Sincerely,

G E Mitchell

Grant E. Mitchell
Senior Attorney (RESPA)

Enclosure

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October 5, 1990

Mr. Edward M. Malan
Senate Committee on Banking, Housing, and Urban
Affairs
Room SD 534, Dirksen Senate Office Building
Washington, D.C. 20510

RE: RESPA Hearing

Dear Mr. Malan:

I have reviewed the transcript of the RESPA hearing on September 19, 1990 at the Senate subcommittee level. Enclosed are four pages with minor clarifications marked thereon as corrections to the record.

It was also noted during the hearing that participants could submit additional comments for the record. The Prudential Real Estate Affiliates, Inc. wishes to submit the following statement for inclusion in the record:

> There have been several questions and comments during the hearing as to whether the real estate broker in performing computerized loan origination services is being paid for a function which the real estate broker has always performed. The Prudential Real Estate Affiliates, Inc. believes that the operation of such systems at the real estate broker's office is a mortgage brokerage function which, historically, has been performed by mortgage brokers or loan solicitors. Furthermore, the mortgage brokers and loan solicitors receive compensation for these services as they have an actual value in being a part of the mortgage origination process. The function that real estate brokers generally perform in the absence of these systems is to refer the home buyer to a mortgage broker or mortgage banker to obtain a loan for completion of the transaction. On the other hand, the review and analysis of loan products on a computerized system at the real estate broker's office is a detailed process which has a value separate

> from real estate brokerage. It is also an added benefit to the consumer in providing increased involvement in selection of the lender and products rather than merely being referred by the real estate broker to the provider of loan products. Furthermore, the preparation of documentation to initiate the application process is certainly a function which is not generally performed by real estate brokers. The mortgage banking industry pays compensation to mortgage brokers for these same services with additional compensation being paid for services through the point of underwriting. There is no duplication of functions by virtue of the fact that services are performed at the real estate broker's office rather than by a mortgage broker or a loan solicitor who is compensated by the mortgage banker.

Please include the foregoing in the record. If you have any further questions, do not hesitate to contact the undersigned.

Very truly yours,

STANLEY M. GORDON

SMG:pn

NAMB

National Association of Mortgage Brokers
706 East Bell Road • Suite 101 • Phoenix, AZ 85022 • Telephone (602) 992-6181

Statement of

NATIONAL ASSOCIATION OF MORTGAGE BROKERS
(NAMB)

Before the

U.S. SENATE
SUBCOMMITTEE ON HOUSING AND URBAN AFFAIRS

On

"REAL ESTATE SETTLEMENT PROCEDURES ACT (RESPA)"

Wednesday, September 19, 1990
Washington, DC

NAMB

National Association of Mortgage Brokers
706 East Bell Road • Suite 101 • Phoenix, AZ 85022 • Telephone (602) 992-6181

September 19, 1990

Senator Alan Cranston,
Chairman, Senate Subcommittee on
Housing and Urban Affairs
Dirksen Senate Office Building, Room 538
Washington, DC 20510-6075

Re: NAMB Testimony on RESPA related issues

Dear Senator Cranston,

The National Association of Mortgage Brokers (NAMB), a not-for-profit professional society, welcomes this opportunity to present its viewpoints on the complex and controversial issues of RESPA.

NAMB represents the relatively new and beneficial industry of professional Mortgage Brokering - an industry comprised mainly of small, privately owned businesses providing a positive economic service for the consumer, the community, the lender and the real estate broker.

Purpose

Our purpose in addressing this committee today is to insure that each of the committee members and staff understand the function, benefit, and special regulatory requirements of Mortgage Brokers.

NAMB Background

NAMB is a not-for-profit professional society incorporated in 1973 which provides educational, certification, networking and legislative services to residential and commercial Mortgage Brokers across the nation. In the process, the members and their organization work to improve the quality and professionalism of Mortgage Broker services available to the public. Through its national professional members and affiliated state organizations NAMB now represents over 3,700 small business members across the nation who are part of an industry estimated to originate between 55% to 65% of all residential mortgage lending in the nation.

NAMB's Role in The Industry

During its entire history, NAMB has worked to promote the professionalism of the Mortgage Broker. Today we are involved in: education through seminars and conferences; professional certification programs designed to insure an educated and experienced Mortgage Broker; fraud prevention and awareness campaigns designed to educate and assist both our members and the wholesale lenders; networking through P.C.-based bulletin boards, membership rosters and newsletters; public awareness programs which explain the economic benefits of our industry through video productions, brochures, public speaking and other media; and working with various federal and state legislative and regulatory bodies to let them know the needs and benefits of our industry.

Mortgage Brokers Defined

A Mortgage Broker is a trained real estate financing professional who, as their major business and for a fee, puts together a lender and a borrower after having thoroughly reviewed the needs and capabilities of that borrower, the characteristics of the borrower's property and the various lending programs available from a wide range of lenders. They do this in compliance with and under the restrictions of all state and federal laws relating to Mortgage Brokers.

The Mortgage Broker completes the origination function in the life cycle of a mortgage. After having trained, been licensed, established a business, being approved by lenders, advertising, attracting customers and taking an application, the Mortgage Broker accomplishes what is really the most crucial phase in their part of the origination function, the processing phase.

During the processing phase the Mortgage Broker completes all the verifications of employment, deposits, mortgages and other debt; orders the appraisal, credit reports, and preliminary title; prepares the initial Reg-Z and Good Faith Estimate disclosures; completes submission sheets, borrower assertions, and final FNMA Form 1003s, or mortgage applications. The final package is then submitted to the specific lender which has been selected by the Mortgage Broker as having the best combination of rates, points, terms, and record of closing. Since a good Mortgage Broker is familiar with the qualifying requirements for multiple lenders, the same Mortgage Broker has more than a 90% closing rate the first time a package is submitted to a lender. A single lender CLO doesn't have that same success rate because all of their packages are submitted to the same lender regardless of the applicability of the loan programs they have available.

Lenders are moving targets in that the programs offered by them and the rates inherent in each program change quite frequently, sometimes more than once a day. A Mortgage Broker offers the opportunity to go to a different lender at the last second if the institutional programs have changed or if the circumstances of the borrower or the property warrant changing. Single lender CLOs don't offer that flexibility.

A mortgage banker is distinguished from a Mortgage Broker in that, under state law definitions as to the functions performed, the mortgage bankers frequently use their own funds and/or service the loans after closing. A Mortgage Broker in most cases cannot.

A real estate broker receiving a fee for only taking an application and referring it to a lender would fit neither of the above definitions. They provide none of the benefits of either a Mortgage Broker or a mortgage banker. If a CLO "captures" the processing of a mortgage application, and it is really during the processing phase that a Mortgage Broker makes the final and most informed decision as to which lender a package will sent, then the borrower has lost the capability to choose between lenders. The market changes every day and most of the single lender CLOs are very rarely the best situation for the borrower.

Most Mortgage Brokers employ no more than four to six employees on staff. Most of the companies are incorporated and privately-owned by the manager or chief originator for the company. Very few of them are what we would refer to as "deep pockets". Many of the owners are former loan officers of mortgage lending financial institutions. Some estimates place the number of Mortgage Brokers nationwide as high as 40,000. Conservative estimates place the number of actual operating retail businesses at around 10,000.

Over the past two years various sources and surveys have tried to determine the amount of residential lending originated by Mortgage Brokers. The best estimates available put the 1988 originations by Mortgage Brokers at somewhere between 47% and 65% of all residential mortgages generated. If the 1988 total residential mortgage origination volume was around $365 billion, the amount generated by Mortgage Brokers would then be somewhere between $171 billion and $237 billion. Our sources all agree on one thing: the figure has been increasing substantially in recent years.

Since knowing these figures is so important to understanding the real estate finance industry, NAMB would volunteer its resources to work with HUD or anyone else in developing more meaningful figures. At this time, the federal figures provided through HUD refer to the dollar amount of loans originated only in terms of the actual lender of record, not in terms of who took the application and processed the mortgage.

The major growth in the industry in terms of numbers of Mortgage Brokers occurred during the 1980-1987 time period and most of the firms formed originally relied on manual processing systems. The majority of those mortgage brokerages have since undergone a radical transformation into automated processing. For small businesses this was a difficult transformation because of the capital and time investment required. The reason for automation was the huge volume of loans being originated in the 1986 and 1987 time period coupled with the personalized service offered by Mortgage Brokers and advances in microchip technology.

Today, the majority of the residential mortgage brokerage industry has automated with everything from the fax machine to computerized application processing, document preparation, computer accessed credit reports, shared-use on-line rate systems, and local area networks. Many of them are tied into the very CLOs which are the subject of so much comment today. Although small, Mortgage Brokers as entrepreneurs are very efficient providers of an origination function which in the past had been very expensive to the financial institutions which provided the service.

The Economic Benefits of A Mortgage Broker

A Mortgage Broker provides a positive economic benefit to three groups: the consumer, the community, and the lender.

The consumer benefits in that the Mortgage Broker provides them the opportunity to shop from among the whole spectrum of local, state and nationwide lenders rather than just the few local lending institutions available. As a result, the consumer typically obtains better rates, points and terms than they would otherwise, and does so with a much better success rate.

The community benefits in that the Mortgage Broker brings into the community funds for real estate investment from all across the nation, funds which would not have otherwise been available. These funds, by the way, are very frequently at rates below those in the local market and force the local institutions to become more competitive in terms of rates.

The lender benefits in being able to adopt the flexibility of entering or leaving a market quickly and easily with no heavy investment of capital for a brick and mortar location, no staff of managers, loan officers, processors and receptionists requiring salaries and benefits packages, and no expensive advertising programs. All of this overhead is borne by the Mortgage Broker.

RESPA - THE BACKGROUND

When RESPA was written, the real estate industry needed a way to eliminate kickbacks. The referral of business within the industry was based solely on referral fees and not on quality of service and had become rampant with misuse and conflict of interest. The answers to those problems were to require disclosures, to define what a kickback and a conflict of interest were, and to make such things illegal. This is as important today as it was then.

What is different today is that there has been a change in technology and terminology. This confuses some of the issues. There has also been the development of a whole new industry on a massive scale, the mortgage brokerage industry. None of this has been taken into consideration prior to this point by existing regulation. We intend to address these changes in our testimony today.

RESPA - THE ISSUES

Mortgage Broker Exemption

Our position is that RESPA should be modified to make it clear that Mortgage Brokers may be paid a fee for the service they provide and not have to make additional disclosures beyond those already given, which are the same as those a lender provides. This may be accomplished through the addition to RESPA of a Mortgage Broker Exemption. An attempt was made to create such an exemption in the HUD leaked draft of RESPA changes in December of 1988. There are many reasons for such an exemption and they are not related to either the question of real estate broker kickbacks or CLOs.

First, in most cases professional Mortgage Brokers dealing in residential real estate are already complying with a full slate of disclosure requirements through Reg-Z ("Truth-in-Lending"), the "Good Faith Estimate" requirements of RESPA, Reg-B ("The Equal Credit Opportunity Act"), FTC rate advertising guidelines, and through distribution of the HUD Settlement Costs Booklet and the Consumer Handbook on Adjustable Rate Mortgages, if applicable. All of this is in addition to the requirements of the Uniform Settlement Statement (HUD-1) form, which is prepared at closing. These, if done properly, already disclose the full cost of doing business with a Mortgage Broker. There is no need for another Mortgage Broker disclosure form under these circumstances.

Secondly, the work done by a Mortgage Broker encompasses a great deal more than just the "naked referral" of business. It involves, as stated before, analyzing and qualifying for alternative lenders and loan products, the entire processing function, the initial underwriting of the package and, sometimes, even the preparation of loan documents. The scope and effort of the work and the resources required in terms of equipment and facilities are, on the whole, no different from the resources required for a real estate broker and, in terms of staff, are significantly greater than for a real estate broker. The Mortgage Broker also has to have additional support staff for processing, underwriting and document preparation.

Thirdly, over half the states in the nation, representing the vast majority of all real estate transactions in both dollar amount and number of transactions, have now recognized that there is a need to separately regulate Mortgage Brokers. This is in itself recognition of the important part that Mortgage Brokers play in the real estate finance and financial institutions market. Many of the states have further recognized the broad scope of experience and unique knowledge that is required in order for Mortgage Brokers to properly and professionally serve the interests of the public. In those states such things as mandatory testing, experience requirements, education requirements, bonding, periodic compliance examinations and initial and periodic licensing fees are in force to insure that the public is being protected. Where those requirements exist on a practical basis NAMB supports them; where they do not exist NAMB promotes their practical and informed development. They are necessary and anyone participating in obtaining real estate finance for compensation should be subject to them.

Finally, when considering pure referrals versus the professional Mortgage Broker approach of full processing, Mortgage Brokers should be allowed to charge for their services by basing their fee on the size of the loan and allowing the market to determine whether or not the fee is appropriate. This is the way the wholesale lending industry currently operates across the nation. If the fee charged by a Mortgage Broker is market competitive, then the consumer will pay it. If the fee is not market competitive, then the consumer will go elsewhere for financing. Any mortgage brokerage exemption should be structured to permit this.

Referral Fees

To us, the area of permitting real estate brokers to be paid for loan referrals in addition to their sales commission is the most complicated and confused area of the entire RESPA conflict: a multi-issue, multi-interest, multi-billion dollar question. Everyone has a different way of quantifying or defining the issues. For purposes of our presentation we will present them as follows:

Kickbacks: In the context of RESPA a kickback occurs when:

"A person accepts any fee, kickback or thing of value pursuant to any agreement or understanding, oral or otherwise, that business incident to or a part of a real estate settlement service involving a federally related mortgage loan shall be referred to any person."

That constitutes a "section 8" violation.

Kickbacks should not be allowed. We agree that they are inappropriate and hurt the consumer. RESPA was created to eliminate them. If for some reason, HUD decides that a particular system does not involve a kickback, then they should change the regulations to make it clear that that particular system can be used by anyone in the industry, not just the few that can afford the large legal and consulting fees which current holders of HUD private opinions in these areas can afford.

Conflicts of Interest: In our opinion, the payment of a referral fee to a real estate broker for the referral to a lender of a mortgage application, even if the real estate broker does more than a naked referral, constitutes a conflict of interest. The real estate broker, under the laws of agency, represents the interests of the seller, not the buyer.

A recent case before the Department of State in New York addressed these issues. In Department of State, Division of Licensing Services vs. Home Market Realty Corp., it was found on February 26, 1990 of this year that the real estate broker

> "had the duty to the seller to obtain a purchaser for the house and to take those actions which were required to further the sale, while he had a duty to they buyers to assist them in obtaining a mortgage on the best terms possible. Therefore, he was in the position of having the obligation to search for the best mortgage terms available, which could delay the sale, and of assisting the buyers to make application for mortgages even in situations where it was possible that because of the favorable terms applied for the application might be rejected, resulting in the possible cancellation by the buyers of the contract to purchase the house."

In essence, it was felt that the real estate broker had operating improperly.

Payment by the buyer of any funds to the real estate broker would be for a service in which the real estate broker cannot in good conscience say they will always make the decision which best serves the interests of the borrower. They will make the decision which best serves the interests of the seller, their client.

It is impossible for the real estate broker to provide full disclosure to both the seller and the buyer and still represent them both fully. If, for example, the real estate broker has to tell the seller of problems with the borrower's funding, that is to the detriment of the borrower. Many of our members who are dual licensed as both Mortgage Brokers and real estate brokers have emphasized this point to us repeatedly.

Additional Disclosures: Again, we don't feel additional disclosures actually eliminate the problem of conflicts of interest; they just point it out and allow someone, a usually uniformed borrower, to assume the risk. We feel in this case the borrower usually is uniformed since they may only enter into a transaction of this nature once or twice during their lifetime. They also are extremely vulnerable at the point this disclosure is required because they feel the acquisition of the house they just selected for their future home is "on the line". The only person they may have had contact with at this point is the real estate broker, the one who is representing the seller.

Fees for Services: We don't disagree that someone should be paid a fee for the services they perform as long as those services don't create a conflict of interest and are of a valid economic benefit. We are arguing that point for ourselves when talking about the manner in which Mortgage Brokers calculate their own fees.

Federal versus State Regulation: In the absence of definitive regulation at the Federal level, quite a few of the states have passed laws outlawing the payment of fees to real estate brokers for the referral of mortgage business. We support such efforts by the states and feel that this is a trend that will continue so long as the federal government does not provide the direction needed in this area.

As mentioned before, more than half the states now have regulation regulating Mortgage Brokers, and, when it is practical and well thought out, we support such regulation. However, we feel that the trend toward fifty states separately regulating mortgage lending and origination is confusing and difficult for those who work in the industry. It has contributed to instances of fraud or misrepresentation by individuals operating on the fringes of the industry. As an example of the confusion, a Mortgage Broker as defined by one state may not even be a Mortgage Broker in another state. This is a situation which has to be corrected. As an industry, we are working at the state level to do so.

Licensing activities by the states support our belief that the financing of real estate is an activity and a body of knowledge which requires its own separate laws and regulations. If a real estate broker wants to be paid for arranging financing of a mortgage for a buyer, then that real estate broker should be licensed and regulated under those laws and regulations, not as a real estate broker. To allow the real estate brokers to do so under their existing licensing does not take into account the additional knowledge and experience required. This can only end up hurting the consumer.

According Mr. Robert H. Elrod of Orlando, FL, who is on NAR's task force on RESPA:

> "...in the last decade, the complexity and array of mortgage-related services have grown astronomically.
>
> To keep up with all the changes takes a lot of education, study and investment in technology, and it requires a lot of time that it didn't use to."

We would agree completely with his comments and offer them as further support of our arguments for separate licensing and regulation of Mortgage Brokers.

Steering: The question has been raised as to whether or not a real estate broker, if paid a fee for a referral, will refer the mortgage to the lender which pays, or allows to be paid, the highest fee. In our opinion, this answer is almost always an obvious "yes". Experience in the New York City area seems to have confirmed this. The only competing reasons given for steering applications to these same lenders, whose rates typically are higher than market, were, according to the March, 1990, issue of *Mortgage Banking*:

> "...the looseness of the underwriting and good odds for high-risk borrower approval, coupled with the virtual absence of time-consuming verifications..."

We submit that any lender promoting such programs is on the road to being a candidate for federal supervisory action. Mortgage brokers have learned that the lenders who lend on the marginal properties and to the high-risk borrowers are not long-term players in the market.

The Wall Street Journal , Wednesday, April 11, 1990 in its Real Estate column, quotes Sheshunoff Information Services, Inc., of Austin, TX, as indicating that Citibank has

> "two units in the top 50 list of big banks with high percentages of problem loans."

The real estate broker has only two interests, closing their seller's sale and making money from the deal. If they can get the buyer's loan at Institution X and make $500.00 or deliver it to Institution Y and receive $1,000.00, it'll go to the latter every time - no doubt about it.

For example, in Queens, New York, Citibank controls over 20% of the mortgage market while their rates and points are unquestionably the highest in the market. Why does Citibank control the market? It is the territory where Citibank originally targeted their "Power Broker" program and it is an area consisting of a high percentage of minority borrowers. In Queens virtually every real estate broker is a Citibank

"Power Broker" and almost always earns fees on both sides of the transaction.

If a member of this committee would like to experience what is happening to borrowers in Queens, we could easily arrange to walk into various real estate broker offices and ask, "What do I have to do to have business referred to my office?" If we can approve loans faster and with better rates than our competitors, then we should be able to develop business. However, the answer is that the business will be referred to the highest bidder.

Queens is an extreme example. However, in the suburbs of New York City, for example Long Island, the situation is almost as bad with Citibank controlling about 10% of the mortgage market with their "Power Broker" (referral fee) program.

Our own association surveys done by our members throughout the nation have shown that rates and points offered by these highly touted single lender CLO programs are consistently higher and more expensive than the other programs available in the same market. Where then, are the benefits to the consumer? What we have is an example of great salesmanship of an inferior product.

There have been discussions regarding support for additional changes in state laws similar to the one passed in Pennsylvania which would limit real estate brokers to receiving only $100.00 for mortgage referrals to lenders. We feel that although this might be a compromise within the presently divided real estate industry, it is another example of how compromise frequently produces imperfect systems and, in fact, a compromise of the basic underlying moral tenants when the issues are difficult. We would rather support additional changes in state laws similar to those in the many other states which specifically don't allow payment of mortgage origination fees to real estate brokers or, conversely, only allow such payment to properly licensed Mortgage Brokers.

Professional Service versus Pure Referral: A big issue, in our minds at least, is whether or not the consumer is receiving an actual benefit from the service provided. Will the service provided give the potential borrower a better deal when you consider rates, points and terms? In the case of a single lender CLO, obviously not. The lender is selling only service or speed or institution recognition value, not the best rates, points and terms in the market place. Their system doesn't even promote competitiveness in such a transaction since it is a captive transaction which they don't need to negotiate. On the other hand, if their system had to compete against other similar systems on a rate and terms basis, then competition could be promoted.

Technology versus The Use of Technology: Technology isn't the issue; the use of the technology is. A CLO for the collection and transmittal of mortgage application data is no different than typing a mortgage application and forwarding it by more traditional means such as courier or mail. The only difference is the use of electronic means such as software, modem and computer. Regardless of cost, if the method is cost efficient, the market place will support it. If the method isn't cost efficient, the market place won't support it. Technology which will be cost effective and mortgage applications which are not guided by conflict of interest should be promoted.

1970 Terminology with 1990 Technology: In our opinion, the underlying intent of RESPA isn't out-of-date. The intent was to eliminate kickbacks and conflicts of interest. But, RESPA's terminology is out-of-date with today's technology. Where RESPA has failed, HUD can correct the situation by updating RESPA to take into account today's market and today's terminology. They can partially accomplish this by allowing public comment regarding proposed RESPA changes and the direction of their private rulings. The December 7, 1988, "leaked" draft had the benefit of having received public comment throughout the previous summer and fall regarding the direction HUD's opinions had been taking. We applaud most of the direction taken afterwards as a result of the public airing of their policies.

We also believe that when HUD does issue private rulings they should be less narrowly construed and should be applied to all institutions similarly situated.

Comparative Fees for Services: It is our belief that the Mortgage Broker of today, dealing in Fannie Mae and Freddie Mac conforming first mortgage residential loans, trails the industry in the level of pay received for the value of the services delivered and the amount of work performed.. Typical market rates for the service of such Mortgage Brokers will run from one to two percent of the loan amount. When you consider the savings over the life of a mortgage, and compare the one to two percent they receive to the work done and the fees received by real estate brokers you can readily see the underpayment. If there is any type of cap placed on the fee paid for such services as has been done recently by at least one lender with whom we are familiar, then we feel the same type of cap should be placed on the real estate broker fee.

In most cases, Mortgage Brokers, either because of their low levels of capitalization or because of their state laws, don't qualify to be able to receive servicing fees for the mortgages they originate. Thus, those Mortgage Brokers are totally dependent on their origination fee for their income.

Controlled Business Arrangements: These types of arrangements should be viewed in terms of the potential conflicts of interest mentioned before. If the conflict of interest can't be erased by the disclosure given, then the controlled business arrangement shouldn't be allowed. We don't believe the conflict of interest can be erased. We think it is abusive to the consumer. Disclosure won't help either. It again only transfers the responsibility to an unwary and susceptible public.

Costs to the Consumer: We believe that the ultimate determination of the costs to the consumer can't be found merely by looking at the cost of the terminal being installed in a real estate broker's office, or in the cost paid by the consumer for the taking and referring of an application by the real estate broker. Rather, the cost can only be determined by examining closely how the long-term consumer benefits from the type of loan which is obtained for them through the system utilized.

A professional Mortgage Broker operating only in the interests of the borrower is the one individual who is best suited for truly obtaining the lowest overall, long-term cost for the borrower - regardless of whether the Mortgage Broker places the mortgage with Citibank, Chemical, Prudential, Countrywide, Empire, Lincoln, or through Rennie Mae, or with some lender no one ever heard of and who doesn't have a CLO.

Summary and Recommendations

As you consider the directions to take in the future regarding RESPA, please keep in mind the importance of protecting those benefits which the Mortgage Broker provides to the consumer and the market. Taking the wrong direction in these issues will mean the loss of a significant consumer advocate, the Mortgage Broker. We are a fragile industry - more susceptible than most to the directions of legislation and regulations because of our members' small corporate sizes and low capitalization.

In summary, we would like to recommend that the subcommittee work to insure that the outdated components of RESPA are updated and enforced.

Specifically, we would like to recommend that RESPA be clarified to:

1. Allow Mortgage Brokers to receive a negotiated market place fee for their services which takes into account the specialized and beneficial nature of the service which Mortgage Brokers provide to the real estate borrowers;

2. Not require additional disclosures for Mortgage Brokers which are above and beyond those currently being made for the protection of the consumer;

3. Reinforce and an update terminology which outlawed kickbacks and conflicts of interest; and,

4. Provide support for the separate licensing and registration of any individuals who desire to receive fees for the provision of services to arrange financing for the purchase of residential real estate.

Again, we thank you for the opportunity to submit these comments and wish to express our strongest desire to participate fully in the development of any future proposed RESPA changes or to support the efforts of the subcommittee to improve the existing federal mortgage lending legislation and regulation.

Thank you,

Michael J Hoogendyk

Donald Henig
1990 President

Michael J. Hoogendyk
Executive Vice President

mjh
attachments

gnzlz419.doc

Consumers Union
Publisher of Consumer Reports

Statement of Michelle Meier
Counsel for Government Affairs
Consumers Union
On Mortgage Referral Fees
Senate Committee on Banking, Housing and Urban Affair
Subcommittee on Housing and Urban Affairs
September 19, 1990

Consumers Union[1] appreciates the opportunity to express our concerns about the increasing practice under which real estate brokers accept fees for referring homebuyers to particular mortgage lenders. Our statement contains our analysis of why mortgage referral fees harm homebuyers and should be prohibited.

An Overview of the Business Arrangements Involved

In recent years, several mortgage lenders have established new marketing programs under which mortgage products are sold through real estate brokers, often using computerized communication networks. Participating brokers can obtain fees for each mortgage loan originated and/or processed through the program.

These referral fees are paid by the lender or the borrower depending on whether the broker participates in a lender-pay or consumer-pay program:

> **Consumer pay programs:** Citicorp's Mortgage Power program is one example of the consumer-pay version. Under the program Citicorp sells a mortgage product that is slightly discounted in relation to its other mortgage loan products, but slightly

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[1] Consumers Union is a nonprofit membership organization, chartered in 1936 under the laws of the State of New York to provide information, education, and counsel about consumer goods and services and the management of family income. Consumers Union's income is derived solely from the sale of Consumers Reports, its other publications and films. Expenses of occasional public service efforts may be met, in part, by non restrictive, noncommercial contributions, grants, and fees. In addition to reports on Consumers Union's own product testing, Consumer Reports, with approximately 4.5 million paid circulation, regularly carries articles on health, product safety, marketplace economics and legislative, judicial and regulatory actions which affect consumer welfare. Consumers Union's publications carry no advertising and receive no commercial support.

more expensive than the products offered by many of its competitors. Citicorp markets its product exclusively through real estate brokers and other third parties. Participating brokers pay Citicorp for the right to participate in the program, and they are authorized by Citicorp to charge the consumer "what the market will bear" for the service. According to Citicorp, most brokers do not impose any charge on consumers. Others charge up to 200 basis points. According to Citicorp the "typical" fee is about 50 basis points.

Lender-pay programs: The program run through a subsidiary of the Prudential Insurance Company is an example of the lender-pay version. The subsidiary, Prudential Real Estate Affiliates, is a real estate broker/franchisor. It operates and owns a computerized loan origination network that connects its real estate broker/franchisee with up to 9 lenders, including another Prudential mortgage lender affiliate. The twist here is that the real estate broker/franchisees do not directly charge the consumer for the mortgage referral service. Rather, for each loan originated, the participating lender pays the network operator/franchisor $425. The network operator/franchisor pays the broker/franchisee $100 for each loan processed.

These Business Arrangements Can Steer Consumers to Bad Mortgage Deals Because Homebuyers Frequently Rely on the Broker for a Mortgage Lender Referral

These newly-developing arrangements between real estate brokers and mortgage lenders give brokers a financial incentive to steer homebuyers to participating lenders -- even though the consumer could get a better deal elsewhere. Any steering effort is likely to be highly successful since the real estate broker often plays a critical role in the homebuyer's selection of a mortgage lender.

Once a contract to purchase a home has been negotiated between buyer and seller, the buyer often turns to the real estate agent for mortgage lender and other referrals. In fact, a 1980 report prepared under contract with HUD by Peat, Marwick and Mitchell showed that 75% of the consumers surveyed were referred to mortgage lenders by the real estate broker, and 39.5% of the consumers surveyed actually chose their mortgage lender as a result of a referral from the broker.

There are several reasons consumers rely on real estate brokers for advice in selecting a mortgage lender. First, they enter the mortgage market very infrequently. The average life of a mortgage loan -- approximately 7 years -- should also roughly reflect the average frequency with which consumers enter the mortgage market. Consumers simply lack the market experience to distinguish among lenders on the basis of honesty, reliability and efficiency. Consumers also frequently lack the sophistication and/or information necessary to distinguish among lenders on the basis of price.

Real estate brokers, on the other hand, deal with a variety of mortgage lenders on a routine basis. This makes them a good source of information about these lenders, provided it is impartially given.

Beyond information, consumers rely on the broker becasue they know the broker can also influence the business practices of mortgage lenders. Brokers have this clout because lenders rely on them for referrals. Brokers can exercise this market clout to the homebuyer's benefit by, for example, pressuring lenders relying on their referrals to expedite the underwriting process or honor lock-in commitments.

Most Homebuyers Do Not Realize that the Real Estate Broker is an Agent of the Seller

Finally, consumers also rely on the real estate broker because they trust the broker to act in their best interest. About a decade ago, the Federal Trade Commission conducted a study that clearly indicated that many consumers do not realize that the real estate broker is an agent of the seller. Consequently, the consumer often believes that the cooperating broker acts only in his best interest. Afterall, the consumer spends a great deal of time with the broker and builds a chummy relationship with him during the weeks and months they spend together looking for the right house.

Referral Fees Should Be Prohibited -- The Real Estate Broker Should Have No Financial Interest in the Homebuyer's Selection of a Mortgage Lender or Other Service Provider Beyond That Created by the Agency Relationship with the Seller, Which Should Be Prominently Disclosed.

Real Estate Brokers Already Have a Financial Interest in The Homebuyer's Selection of a Mortgage Lender Because They Are Agents of the Seller -- Their Impartiality Should Not Be Furthered Compromised

Under longstanding principles of agency law, both the listing agent and the participating agent are agents of the seller. Both brokers receive their commissions directly from the seller. Consequently, homebuyers should not rely exclusively on the broker for a mortgage loan referral since the broker has no obligation to serve the homebuyer's interest in making this referral.

In some cases, the interests of the seller and the homebuyer in the homebuyer's selection of a mortgage lender will conflict.

For example, a seller's interest in an expeditious settlement may conflict with the homebuyer's interest in a low rate mortgage if the documentation and underwriting requirements for that mortgage are more time-consuming than the requirements for a higher-cost mortgage.

Similarly, even where the interests of the seller and buyer do not conflict, the seller frequently has little interest in the terms of the mortgage loan eventually secured by the homebuyer. Consequently, the real estate broker may simply refer the homebuyer to a lender that is likely to finance the loan, rather than a lender that will finance the loan at the best terms possible. This will depend on the aptitudes, conscientiousness and interests of the individual broker and its agents.

Since the homebuyer is forced to rely heavily on the broker for mortgage lender and other referrals, the broker should be as impartial as possible in making these referrals. The broker's agency relationship with the seller (and its interest in getting a commission by bringing the deal to settlement) makes it impossible for the broker to give the homebuyer completely impartial advice. The real estate broker's ability to give the homebuyer impartial mortgage lender referrals should not be further compromised by allowing the broker to receive compensation for these referrals.

A Referral Fee Prohibition is Not Enough -- Consumers Need Better Information from Lenders and Real Estate Brokers About Mortgage Products

A prohibition on referral fees for real estate brokers is essential -- but it is not enough to protect consumers from getting steered to bad deals by real estate brokers because:

-- Referral fees that pass directly from the lender to the broker can be difficult to detect and expensive to enjoin.

-- Such a prohibition does not address the conflict of interest the broker faces in making even uncompensated mortgage referrals to the homebuyer when it is really an agent of the seller.

Consumers need:

-- Better information on mortgage loan products to lessen their reliance on referrals that may involve undetected kickbacks. For example,

o Lenders should be required to disclose in writing the key terms they are offering before the application process begins and fees are paid. (Currently, lenders are required by federal law to make pre-application disclosures only for adjustable, rather than fixed-rate, mortgage loans, and even these disclosures are far from complete. For example, they do not require the lender to honor the terms disclosed, or even to state how long the terms are available. Nor do they require lenders to disclose the points they are charging.)

o Real estate brokers that forward mortgage applications to particular lenders should be required to make the same disclosures at the pre-application stage. (Under current law, mortgage brokers are not required to make any Truth-in-Lending disclosures even though they often represent specific terms to the consumer.)

-- Full and complete disclosure about the relationships between the parties.

o Real estate brokers should clearly and conspicuously disclose that they represent the seller, not the buyer, and that the interest of the seller may conflict with the buyer's interest in the selection of a mortgage lender.

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STATEMENT OF
Stephen B. Ashley
President & C.E.O.
Sibley Mortgage Corporation
on behalf of the
MORTGAGE BANKERS ASSOCIATION OF AMERICA
before the
SUBCOMMITTEE ON HOUSING AND URBAN AFFAIRS
of the
COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS
UNITED STATES SENATE

Hearings on

RESPA--The Real Estate Settlement Procedures Act
Implementation of Referral Fee Programs under HUD Interpretive Rulings

September 19, 1990

Mr. Chairman and Members of the Subcommittee, I am Stephen B. Ashley, President & C.E.O. of Sibley Mortgage Corporation, located in Rochester, NY. I am also currently serving as Chairman of the Legislative Committee of the Mortgage Bankers Association of America (MBA).* Accompanying me today are Warren Lasko, MBA's Executive Vice President, Michael J. Ferrell, MBA's Senior Staff Vice President and Legislative Counsel, and Sharon M. Canavan, MBA's Deputy Legislative Counsel.

MBA appreciates the opportunity to appear before you today to testify with respect to the Real Estate Settlement Procedures Act (RESPA) and the growing acceptance of referral fee programs as a result of private opinion letters issued by the Department of Housing and Urban Development (HUD) under former HUD Secretary Samuel Pierce.

RESPA is a housing issue and RESPA is a consumer issue. MBA is deeply concerned over the proliferation of mortgage referral fee programs that are undermining the integrity of the mortgage lending process and adding to the cost of housing. People are paying too much for their homes when unnecessary referral fees are built into closing costs or are added to the lifelong cost of a mortgage.

Mortgage lending has become a highly complex, sophisticated, and competitive business. Lenders across the country can offer programs with many new features that create significant benefits to homebuyers and borrowers. But referral fees undermine that competitive environment by introducing inducements into what should be an open process.

Inducements in the form of fees to real estate brokers/agents lead to the steering of potential borrowers to a single lender or set of lenders, who are willing to pay referral fees or who have created programs that depend on real estate agents/brokers charging borrowers directly for referrals to lenders. Steering that is motivated by a fee means that the borrower may not be getting the best advice about financing. Real estate brokers/agents are in a unique and controlling position, with considerable influence over the homebuyer's financing decision. Their recommendation should be based on the best combination of interest rate, terms, and services--not on the size of the referral fee paid directly or indirectly by the borrower. Even where the fee is paid by the borrower, if the real estate broker/agent has a prearranged agreement to refer borrowers to a single lender, the borrower is not assured of receiving objective advice.

Prior to the enactment of RESPA, many real estate transactions involved non-competitive practices. The payment of kickbacks and referral fees in order to steer customers to a particular mortgage lender, title search or insurance firm was commonplace. RESPA was enacted to clean up these practices.

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* The Mortgage Bankers Association of America is a nationwide organization devoted exclusively to the field of residential and commercial real estate finance. MBA's membership comprises nearly 2,600 mortgage originators and servicers, as well as investors, and a wide variety of mortgage industry-related firms. Mortgage banking firms, which make up the largest portion of the total membership, engage directly in originating, selling, and servicing real estate investment portfolios.

Members of MBA include:

- Mortgage Banking Companies
- Commercial Banks
- Mutual Savings Banks
- Savings and Loan Associations
- Mortgage Insurance Companies
- Life Insurance Companies
- Mortgage Brokers
- Title Companies
- State Housing Agencies
- Investment Bankers
- Real Estate Investment Trusts

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But the recent HUD Opinion Letters have reopened the door to paying referral fees. As the practice of paying referral fees spreads, many lenders feel they have no choice but to pay the fee that many real estate brokers/agents are demanding, if they want access to borrowers. The result has been a proliferation of kickback programs. Furthermore, there has been a dramatic increase in programs that provide blatant kickbacks for referral of business and are a clear violation of RESPA, because HUD is viewed as no longer enforcing even blatant violations.

Last year MBA instituted a "clearinghouse" for reporting possible RESPA abuses. We received numerous examples of abuses ranging from lenders offering prizes to brokers/agents who refer business, to real estate brokers/agents demanding a fee in exchange for referrals. We also received examples of excessive fees for services rendered. These abuses have been brought to HUD's attention. We are aware that HUD is investigating these abuses in order to take appropriate action.

Legislative Background

The Real Estate Settlement Procedures Act was enacted in 1974. The Act has two major purposes:

(1) to *inform* consumers about settlement costs and services, and

(2) to *protect* consumers from excessive settlement costs and, when possible, reduce settlement costs.

Section 2 of the Act, "Findings and Purpose" states the following: "(a) The Congress finds that significant reforms in the real estate settlement process are needed to ensure that consumers throughout the nation are provided with *greater and more timely information* on the nature and costs of the settlement process *and* are *protected from unnecessarily high settlement charges caused by certain abusive practices." (Emphasis added)*

These principles are as important today as they were in 1974. We believe that any new mortgage origination programs should be encouraged as long as they adhere to these principles. Our concern is that HUD has approved programs that violate these basic consumer protection principles.

RESPA clearly prohibits certain kickbacks and unearned fees in real estate settlement transactions. In its key section on this subject, the Act states:

> "Sec. 8(a) No person shall *give* and no person shall *accept* any fee, kickback, or thing of value pursuant to any agreement or understanding, oral or otherwise, that business incident to or a part of a real estate settlement service involving a federally related mortgage loan shall be referred to any person. (b) No person shall *give* and no person shall *accept* any portion, split, or percentage of any charge made or received for the rendering of a real estate settlement service in connection with a transaction involving a federal related mortgage loan other than for services actually performed." *(Emphasis added)*

HUD's Actions

Beginning in 1986, HUD, through the issuance of private opinion letter rulings, has approved two basic varieties of referral fee programs. It should be noted that these private opinion letters were issued at the same time and by the same HUD Administration that allowed abuses in other HUD programs.

Borrower Pay. Even though the real estate agent has a pre-arranged relationship with a single or select group of lenders, HUD has stated that real estate agents can collect fees from borrowers for referring them to lenders. It is not required that loan processing or other work be performed by the real estate agent.

Lender Pay. HUD has stated that lenders can pay real estate agents fees for services rendered and expenses incurred, under the theory that there has been work performed. Specifically, concerning computerized loan origination systems, HUD has approved the payment of fees to cover computer costs. These fees can be paid for each loan referred without regard to the actual computer service cost.

On May 16, 1988, HUD proposed revised and amended RESPA regulations for comment. This proposal was published after five years of delay, to implement Congressional amendments enacted in 1983. Those 1983 Congressional amendments involved "controlled business arrangements", but the proposed rules included changes that affected more than controlled business arrangements. In the proposed regulations, HUD included a "borrower pay provision", which would allow fees to be paid by the borrower to a real estate agent for a referral to a lender. HUD received over 2,000 comment letters in response to the proposal. No final rule was ever published.

However, a draft final rule dated December 7, 1988 was prepared and became widely circulated. That draft changed the position HUD had taken previously both in private opinion letters and in the May 1988 proposal. On the referral fee issue, the preamble to the December 7th draft states in relevant part:

> "In response to the comments received, the borrower pay mortgage broker concept was reviewed in detail by the Offices of the FHA Commissioner and the General Counsel. It was decided that a borrower should be able to seek out an independent entity, uninvolved in the settlement transaction, to assist the borrower in locating a lender and obtaining financing. It was concluded, however, that the (previously approved fee) arrangement materially altered this straightforward borrower pay mortgage broker concept. The person receiving the fee was often a real estate broker who was also receiving a sales commission from the seller. As a consequence, the realtor was placed in a conflict of interest situation in which he was able to shape the terms of the sales contract, particularly the financing terms, to assure the expeditious closing of a real estate sale, in order to earn a sales commission, and to exert influence to direct the use of one lender over another, as well as potentially generating a referral fee paid by the borrower. The borrower had not in actuality voluntarily chosen to be assisted by an independent party to obtain a mortgage loan but rather was in a position of being influenced by the realtor to choose a particular lender in part to serve the realtor's own purposes. It was further recognized that under such a borrower pay arrangement, the parties could easily manipulate points and charges in such a way as to disguise referral fees; the borrower after all, was the sole funding source for all charges in the closing transaction."
>
> "For these reasons it was determined that to preserve the legislative intent of RESPA to prohibit referral fees, HUD would withdraw the overbroad borrower pay mortgage broker provision set out in the proposed rule and return to the original concept of an independent mortgage broker uninvolved in the settlement transaction..."

This final rule, though it was drafted and approved by HUD staff and apparently was recommended for publication by the Assistant Secretary for Housing and the General Counsel, was never approved for publication by former Secretary Pierce. No further action has been taken by HUD.

More than two years have passed since the proposed regulation was published for comment. Almost seven years have passed since the law was passed that these regulations were to implement. Congress acted in 1983; HUD still has not acted.

Problems with Mortgage Referral Fee Programs

HUD's own staff text, quoted above from the draft final regulation, captures well the inherent conflict of interest in allowing real estate brokers to receive a mortgage referral fee either from the lender or the borrower. It is fundamentally wrong for a real estate broker, who is receiving a substantial commission from the seller of a home, to have a financial interest in where the buyer of the home gets a mortgage. More specifically, referral fees add to the cost of housing, are unnecessary, distort the market and should be prohibited.

MBA urges Congress and the Department of Housing and Urban Development (HUD) to adopt an interpretation of RESPA that would combat current and future abuses of the consumer protection provisions in that statute by taking a position that would:

-- Clarify that the making of a mortgage is a settlement service under RESPA.

-- Prohibit the payment of referral fees, by borrowers or lenders, in connection with the making or processing of a mortgage to a person who is receiving a commission premised upon the sale of the real estate which is the subject of that mortgage, whether or not work is performed by that person.

WHY REFERRAL FEES SHOULD BE PROHIBITED

1) Referral fees raise the cost of housing.

Referral fees add a layer of unnecessary costs at a time when homeownership affordability is of increasing concern. Even where work is performed by a referring real estate agent, lenders must duplicate this work to ensure the integrity of the mortgage origination process and to comply with insurer and secondary market requirements. The additional fee for duplicative work represents a true added cost and will be passed on to the homebuyer. In cases of "pure" or "raw" referrals--where no work is performed--the referral fee is a particularly obvious additional cost.

Mortgage originators who rely on a referral fee program can make up its extra cost by charging higher points and/or interest rates to borrowers over the life of a loan. Available evidence suggests that an extra $^1/_4$ to $^3/_4$ percentage points in interest rate above the going market rate is not uncommon. An interest rate differential can occur even where the lender has reduced its origination fee in order to provide room for the real estate broker to charge a referral fee.

Fees paid by borrowers or lenders to real estate agents for locating financing are unnecessary. These services have traditionally been regarded as one of the services brokers/agents provide in order to consummate a transaction. Work performed by a real estate agent in helping a buyer obtain financing is work performed for the benefit of the real estate agent's sole client, the seller. Indeed, in the typical presentation that the real estate agent makes to a prospective listing seller, prequalification of prospective buyers and helping the buyer obtain financing are usually services specified to justify the commission.

Referral fees range from as low as $100 to as much as $1,000. However, the real issue is not the size of the fee, but whether any such fee is appropriate or necessary. Home buyers should not have to pay extraneous charges to a real estate agent for help in finding a loan.

Furthermore, in most instances referral fees represent "hidden costs". They are not included in the calculation of the Annual Percentage Rate (APR) required under the Federal Truth in Lending statute. Thus, consumers are unable to comparison shop, based on interest rate, if a referral fee is involved. Also, even at the closing where the borrower receives a form called the "HUD 1" (the settlement sheet that lists fees paid by the borrower and seller), referral fees are generally not reflected there either. So these costs are not generally evident to the borrower.

2) Referral fees encourage adverse steering.

Allowing referral fees to be paid will increase the real danger that referrals will be made based solely on who pays the highest fee to the broker/agent. Instead of helping the borrower find the best financing arrangement as part of their service to the seller, real estate brokers/agents will be encouraged to steer borrowers to lenders that provide the highest remuneration to them or to lenders who will modify the basic fee structure to permit real estate brokers/agents to charge up to $^1/_2$ percent for their referral services. Most unsophisticated buyers rely heavily on referrals made by real estate agents and can easily be manipulated to benefit the real estate agents. This is particularly troubling, because of the close working relationship that develops between the potential borrower and the real estate agent who has helped to find a home.

3) Referral fees discourage competitive mortgage pricing.

Lenders traditionally get business through referrals from brokers/agents. As a result of the private opinion letters issued by HUD, brokers/agents have developed exclusive or limited arrangements with lenders that pay or permit them to charge referral fees. Such brokers/agents have refused to accept information from independent lenders or provide information to borrowers about other lenders who may provide better financing terms for buyers.

With the spread of these programs, market forces are distorted because the amount of the fee payment becomes the overriding consideration in the mortgage selection process (instead of the lender's pricing, quality of service, reputation). When non-referral fee lenders are denied open access to the buyer, that buyer does not have adequate information about better alternative services. Regardless of the competitiveness or attractiveness of a lender's rates, fees, or the quality of its service, buyers may be steered only to those lenders or programs where the highest referral fee is paid to the real estate agent.

As fees escalate and more lenders are forced to pay fees to compete, larger lenders have the financial capacity to raise fees to such a level that many smaller lenders will be unable to compete and will be driven out of the business. Once this occurs, the marketplace will be considerably less competitive and borrowers will have fewer financing options.

Some arguments have been made that MBA is opposed to referral fee programs, because its smaller members are unable to compete with large lenders who have implemented referral fee programs. This is not the case. Referral fee programs close markets and reduce competition. All lenders should have open access to the market and to borrowers, and this access should not be based upon whether or not a fee is paid.

4) Referral fees raise quality control concerns and the risk of mortgage defaults.

The major source of compensation to a real estate broker/agent is the sales commission paid at loan closing. The broker/agent may be tempted to present information in ways that make it more likely that an unqualified borrower will be approved for financing and more likely that the broker/agent will receive his commission sooner. Allowing individuals who already have a vested interest in seeing a loan closed to become overly involved in the mortgage process seriously compromises the lending decision. History has taught the industry an expensive lesson from the problems associated with fraud and abuse in the loan origination process.

Federal policies should not support practices that include inherent conflicts of interest that could undermine the stability of a financial institution. If the institution is insured by the Federal Deposit Insurance Corporation or the loan is federally guaranteed, the Federal government is affected by those increased risks.

5) Referral fees are not payments for work performed or services rendered.

Some argue that a fee is warranted because there has been "work performed" or "services rendered." MBA believes that this argument serves as a simple guise to justify the payment of referral fees.

First, to the extent that work is performed or services are provided, the bulk of the value to the consumer emanating from the "work" or "services" is provided by the lender. Attachment A provides a comprehensive list of the services necessary to process a loan application.

The value often claimed in connection with referral fee programs is the speedy processing. However, the systems that have been developed for speedy underwriting have been developed by *lenders*, not by *real estate agents* who are simply responsible for *inputting* information.

Second, lenders should reverify any information (such as, salary, income, bank accounts, credit reports, debts, etc.) provided to them by third parties when making the underwriting analysis, in order to prevent fraud and ensure appropriate quality controls. Information collected by individuals with a vested interest in the closing of a loan needs to be verified independently to protect the quality of the lender's underwriting decision.

Third, the function provided by the real estate agent in most cases is largely clerical (inputting information into a computer terminal), because the real estate agent provides neither the underwriting analysis nor a willingness to stand behind the information provided as true and correct. Real estate agents are not willing to indemnify a lender in the event that the loan enters default. Indemnification in mortgage lending is required to ensure against either an error in the information provided or even outright fraud that might lead to faulty underwriting and ultimately a default. FHA, FNMA, and FHLMC aggressively pursue lenders to indemnify losses where underwriting errors have occurred or fraud has been committed.

Mortgage documents do not even identify the real estate broker/agent. Furthermore, the lender cannot fire or reprimand a real estate agent in the event that fraud is uncovered. Losses attributable to mistakes and even fraud committed by a real estate agent on mortgage documents are the responsibility of the lender. The ability and legal responsibility to stand behind the information as true and correct is the service that deserves compensation.

6) Receiving a referral fee is a conflict of interest.

Under the standard real estate listing contract, the real estate broker/agent's primary contractual responsibility is to the seller, not the buyer. However, where a borrower pays a referral fee to a real estate broker/agent this implies that a contractual relationship exists between them--a relationship undertaken in addition to the existing contractual relationship between the agent and the seller. This dual contractual responsibility can present a strong conflict of interest. While the real estate agent is in the center of the transaction, the contractual relationships are between the seller and the real estate agent and between the buyer and the lender.

Conflicts of interest arise because the buyer and seller have different and sometimes opposing interests as regards the mortgage transaction. Liberal underwriting and speed of processing are often very important to the seller and the real estate agent. Although the borrower is interested in speedy processing, other concerns are more important: monthly payment, type of mortgage (fixed versus adjustable), and the size of a downpayment. The real estate broker/agent is contractually bound to act in the interest of the seller, and will not be able to offer objective advice and analysis to the potential borrower. For example, because of the seller's desire to close quickly, a real estate agent would be motivated to find a lender with the fastest processing, even though the terms of the loan are not in the buyer's best interest.

Because of the inherent problems in dual contractual relationships most professionals, including lawyers and accountants, are bound by strict ethical standards that prohibit them from representing or advising more than one party in the same transaction. The potential conflicts of interest for these professionals are the same as those that arise for the real estate professional when both buyer and seller are paying fees.

7) Referral fees are unnecessary for technological innovation or rapid loan processing.

Computer technology is an integral part of all modern mortgage lenders' business. The use of modern technology is completely unrelated to the payment of referral fees. Today, highly sophisticated and successful computerized loan origination systems are in use by many firms. Many lenders can provide computerized information on types of loans available and their costs; can provide rapid underwriting and loan approvals for those needing this service; and can perform many of these functions at a buyer's home or in the offices of real estate brokers. These services can be and are being provided by reputable firms without the payment of additional fees.

If used appropriately, technology can work to the consumer's advantage by reducing search costs for the "best" mortgage. Technological developments can accelerate the time from application to closing, reduce origination costs, and lessen a lender's exposure to interest rate volatility. Many of MBA's members have adapted their firms' operations to incorporate these advanced technologies--but do not link their programs to referral fees.

MBA is not opposed to computerized loan origination systems where a borrower is offered a choice of loan programs on a computer screen. However, that choice should not be restricted to programs offered by lenders who are willing to pay a referral fee. That is the *illusion* of choice. Borrowers who are referred to these lenders are unaware that other lenders outside this closed system may be offering more competitive rates.

The use of computerized loan origination systems is a time-saving innovation that can result in lower costs. These cost savings should be passed on to consumers and not used as an excuse to add another layer of costs by paying real estate agents/brokers an extra fee for functions that should be undertaken by trained underwriters who are accountable for loan quality. The other danger is that this system is choking off the access of lenders to consumers. If this happens on a widespread basis, independent lenders who have *not* developed exclusive arrangements with real estate brokers/agents or who do *not* participate in schemes to provide those real estate brokers/agents payments in addition to their sales commission fees, will not get referrals. Without referrals, those businesses will close and will no longer be a competitive force to keep mortgage rates and real estate settlement costs competitive.

Computers have brought great conveniences to modern day life. Yet they should not be used as excuses to increase expenses, but as devices to expedite loan selection and processing. Because a computer makes a process more efficient it should result in lower costs, not another layer of costs.

As a practical matter, real estate agents have long used "rate sheets" dropped off by mortgage companies at the real estate office. It is no more complex, in fact, it is arguably more convenient for the real estate agent to use a computer screen to select various products than to flip through a file folder of rate sheets.

Thus, the point could be made that while computerized loan origination systems hold the potential for reducing consumer search costs and increasing competition by stimulating the flow of information, past experience has shown that they also hold the potential for seriously harming the interests of consumers through uncompetitive practices. Directing consumers only to "referral fee" lenders, and by implication those lenders paying the highest fees, are examples of such uncompetitive practices.

8) Referral fees are prohibited for FHA-insured loans.

Referral fees are prohibited on Federal Housing Administration (FHA) insured loans. HUD has taken this position to protect the generally unsophisticated borrowers who use the FHA insurance programs and to keep the costs low on home financing. RESPA makes no such distinction between FHA-insured and conventional loans and there appears to be little justification for HUD to make such distinctions in its interpretation of the statute. All borrowers should be given the same protection.

9) Disclosure alone cannot solve the problem.

MBA does not believe disclosure alone would be effective in addressing possible abuses. The mortgage origination process has become much more complicated with insurers and investors requiring the buyer's signature on many different forms. With the buyer signing the application form, the HUD 1 Settlement Statement, mortgage documents, ARM Disclosures, occupancy certifications to name a few, the impact of any disclosure form would be lost in the signing of a myriad of forms.

Even if fully disclosed to all parties the payment of referral fees can taint the loan process. Inducements in the form of fees to real estate brokers can lead to steering of potential borrowers to a single lender or set of lenders. Since unsophisticated borrowers rely on the advice of the real estate broker/agent, the broker/agent has considerable influence over the homebuyer's financing decision. Their recommendations should be based on the best combination of terms (e.g. interest rate) and services.

Congress created RESPA's Section 8 to eliminate all kickbacks or referral fees because such payments "tend to increase unnecessarily the cost of certain settlement services" (Section 8(b)(2)). Congress did not require that a payment to be prohibited must in fact be one that increases settlement costs. All such payments are prohibited because they "tend to" increase settlement costs.

10) Acceptance of referral fees will spark a bidding war.

Today, except in a few markets, the practice of paying referral fees affects a small percentage of real estate transactions. If referral fees are not expressly prohibited soon, we will see lenders engage in a bidding war, paying higher fees to secure business, at no additional advantage to the borrower. In markets where referral fee programs have become firmly established, lenders who participate in these programs are flourishing, even if their interest rates are higher than prevailing market rates.

After they were banned by RESPA in 1974, mortgage referral fees were virtually non-existent until 1986 when HUD issued its first private opinion letter. Since then referral fee programs have grown at an alarming rate exploiting the loopholes in RESPA's interpretation created by HUD in its private opinion letters. The vast majority of mortgage lenders disdain the practice, but many lenders are defensively adding fee programs in order to remain competitive in local markets.

Once referral fees become a widespread practice, lenders will be participating in a bidding war to pay for business referrals--and the consumer will pay in higher fees and interest rates. Ultimately, the heaviest price to be paid, if referral fees are sanctioned, would be reduced competition. The field would be left to the oligopoly of a few big players--an unfortunate scenario for homebuyers.

11) States are enacting legislation in lieu of Federal action on RESPA.

Since the issuance of the HUD private opinion letters, some state legislatures have begun consideration of bills to outlaw or restrict the payment of referral fees by lenders or borrowers to real estate agents/brokers. In lieu of Federal action to enforce or correctly interpret RESPA, at least two states, Pennsylvania and Connecticut, have enacted legislation.

In Pennsylvania, the state's Real Estate Commission voted to limit the fees that real estate brokers may charge in connection with mortgage loan originations to $100 per transaction. The fee may only be collected when actual mortgage brokering services are performed. This action marks the first absolute dollar limit on such referral fees that has been established in the country.

In Connecticut, the legislature directed the Department of Banking to promulgate regulations governing the payment of referral fees. The regulations do not set a monetary limit, but provide for the written disclosure of the services to be performed by the broker and the hourly rate upon which the fee will be based. Brokers must provide the buyer with an itemized invoice detailing the services rendered.

A crazy quilt of state legislation interpreting the Federal statute--RESPA--is developing as states react to developing referral fee programs. This trend will continue unless Congress reasserts its jurisdiction over this important consumer issue and acts to reverse the present HUD interpretation of RESPA.

WHAT CONGRESS AND HUD CAN DO

HUD has the authority, and should use it, to end referral fee practices. In preparing the December 1988 version of the final regulations, HUD's career legal staff and most recent former General Counsel reached the conclusion that the Secretary of HUD has sufficient authority to act on this issue. Only because former Secretary Pierce personally declined to approve its issuance did this conclusion not become effective.

Because HUD has not dealt adequately with referral fee abuses, Congress should. It is time for Congress to fill the void through legislative action.

Congress should move to overturn the decision in Department of Housing and Urban Development v. Graham Mortgage Company, by clarifying that the making of a mortgage is indeed a settlement service covered under RESPA. This is noncontroversial.

In the Graham case, decided in 1983, the U.S. 6th Circuit Court of Appeals overturned a lower court decision in Michigan and decided that given the ambiguity in the statute, for purposes of criminal prosecution the making of a mortgage loan was not a settlement service, so providing a thing of value for the referral of a loan was not a violation of the anti-kickback provision of RESPA.

HUD has generally disagreed with the Court's ruling that the making of a mortgage loan did not fall under the purview of RESPA as a settlement activity. Outside of the 6th Circuit (Kentucky, Michigan, Ohio, Tennessee), HUD continued to consider mortgage loans as settlement activities under RESPA and barred kickbacks, fees or the receipt or giving of things of value for the referral of loans.

MBA recommends the enactment of legislation providing two simple amendments to RESPA (attachment B). These amendments would prohibit the payment of a referral fee to anyone who is receiving a commission premised upon the sale of a property and would overturn the Graham ruling. Congress should wait no longer before initiating its HUD-RESPA reforms.

SUMMARY

MBA strongly believes the payment of referral fees or fees for duplicative mortgage origination activities by either borrowers or lenders to real estate agents should not be sanctioned. RESPA was enacted to prohibit the payment of referral fees and this practice should not be allowed to resurface. Allowing referral fees will: create ethical problems where conflicts of interest exist; exacerbate potential for fraudulent documentation where persons other than the lender collect financial information; reduce marketplace competition; and add another unnecessary layer of fees to real estate transactions at a time when mortgage affordability is an increasing concern.

MBA appreciates the opportunity to testify before this Subcommittee and will provide answers to questions or requests for additional information, as requested, for inclusion in the hearing record

LENDER DUTIES/RESPONSIBILITIES: WHAT THEY DO

- Prequalifies Applicant
- Assess a Full Range of Mortgage Products and Matches to Borrower Needs
- Completes Loan Application
- Completes Data Collection to Comply with Fair Housing Act & HMDA Reporting Requirements
- Explains Required Documents to Applicant
- Explains Rights and Obligations of Borrower Including Disclosurres and Other Requirements of TIL, ECOA, and RESPA
- Orders Appraisal and Credit Report
- Initiates Verification of Employment and Deposit
- Ensures Compliance with Privacy Act and Fair Credit Reporting Act
- Explains Flood Insurance Compliance Requirements to Applicant
- Locks in Interest Rate
- Maintains Ongoing Accountability for Loan Quality
- Reviews Loan/Credit Data & Makes Decision on Approval of Loan
- Maintains Ongoing Communication with Borrower Regarding Loan Progress
- Undertakes Quality Control Review
- Takes Marketing Risk
- Assumes Liability

Attachment B

Proposed Amendments to RESPA

Insert at the end of Section 8(a) of RESPA:

> Furthermore, no person shall give and no person shall accept a fee directly or indirectly, from the lender, buyer, or any other source in connection with the making or processing of a mortgage, if that person is receiving a fee or commission premised upon the sale of the real estate which is the subject of the mortgage loan.

Amend Section 3(3) as follows:

> (3) the term "settlement services" includes any service provided in connection with a real estate settlement including, but not limited to, the following: title searches, title examinations, the provision of title certificates, title insurance, services rendered by an attorney, the preparation of documents, property surveys, the rendering of credit reports or appraisals, pest and fungus inspections, services rendered by a real estate agent or broker, the making or processing of a mortgage, and the handling of the processing, and closing or settlement.
>
> NOTE: Underlined language is added to existing provision.

Atta.hment C

REAL ESTATE SETTLEMENT PROCEDURES ACT (RESPA): A CHRONOLOGY

1974 RESPA Enacted.

RESPA Section 8 designed to provide consumers involved in real estate settlement transactions with timely information regarding the nature and costs of the settlement process.

Intended to protect consumers from unnecessarily high settlement costs caused by certain practices, such as kickbacks or referral fees.

Section 8, a. "No person shall give and no person shall accept any fee, kickback, or thing of value pursuant to any agreement or understanding, oral or otherwise, that business incident to or a part of a real estate settlement service involving a federally related mortgage loan shall be referred to any person."

b. "No person shall give and no person shall accept any portion, split or percentage of any charge made or received for the rendering of a real estate settlement service in connection with a transaction involving a federally related mortgage loan other than for services actually performed."

1983 Department of Housing and Urban Development v. Graham Mortgage Company

The U.S. 6th Circuit Court of Appeals overturned a lower court decision in Michigan and decided that given the ambiguity in the statute, for purposes of criminal prosecution the making of a mortgage loan was not a settlement service, so providing a thing of value for the referral of a loan was not a violation of the anti-kickback provision of RESPA.

HUD disagreed with the Court's ruling that the making of a mortgage loan did not fall under the purview of RESPA as a settlement activity. Outside of the 6th Circuit (Kentucky, Michigan, Ohio, Tennessee), HUD continued to consider mortgage loans as settlement activities under RESPA and barred kickbacks, fees or the receipt or giving of things of value for the referral of loans.

1984 HUD Informal Opinions

Lender Pay Programs

First informal opinion rendered by HUD permitting lender payments to real estate brokers involved in computerized loan origination systems (CLOs). These programs are also known as "lender pay programs."

HUD determined that in the case of computerized loan origination systems, lenders paying fees to the real estate brokers for referring loans through the system was actually for "work performed," the use of computer time, and was permissible, even if, as MBA asserted, the fee paid bore little resemblance to actual cost of computer time.

1986 HUD Informal Opinion

Borrower Pay Program

The HUD General Counsel issued an opinion that fees paid by borrowers to real estate agents for referral to lenders did not violate RESPA, even where the real estate agents had pre-arranged agreements to make referrals only to a specified lender or lenders.

1988

May HUD Publishes Proposed Amended RESPA Regulations for Comment

The proposed regulations

Addressed the Graham decision by specifically noting that the making of a mortgage loan was a settlement service.

Reaffirmed its earlier informal opinions that "borrower pay" and "lender pay" programs were acceptable under RESPA.

Considered an expanded exemption for payments by lenders to persons who have brought the borrower and lender together.

July MBA Issues Comment Letter to HUD. Key Points Include:

Real Estate agents should not be allowed to receive a fee related to a mortgage application or origination. Real estate agents should not have a financial interest in where borrowers get a loan.

The proposal to exempt mortgage brokers from RESPA's Section 8 prohibition of borrowers paying fees to those bringing borrower and lender together, as well as a 1986 opinion by the HUD General Counsel effectively allowing real estate agents to charge borrowers referral fees, should be rejected.

RESPA prohibits all referral fees, and that regardless of who is paying and who is receiving, such fees will cost borrowers more.

July HUD RESPA Regulation Comment Period Ends

HUD receives more than 2,000 comment letters.

October HUD Approves Policy Asking Congress for Legislation

Policy resolution calls for federal legislation to clarify RESPA prohibition of referral fees.

December HUD Develops Proposals for Final Rule on RESPA and Referral Fees. Major Points Include:

The making of a mortgage loan constitutes a settlement service covered by RESPA.

A person or party otherwise involved in the transaction (for example the real estate agent) may not receive a fee to bring the borrower and lender together.

A mortgage broker may receive a payment from a lender or borrower for assistance in bringing the lender and borrower together, provided that no other fees are received as a result of the closing transaction. Fees paid to a mortgage broker under this mortgage broker exception must be described on both the good faith estimate and the HUD-1 Uniform Settlement Statement.

CLOs are permissible under the rule. The owner of a CLO may be compensated by the lender or borrower; however, a real estate agent receiving another fee in the transaction may not receive a fee for assisting the borrower in using a CLO system.

Today No Action

HUD has not published any final regulations on RESPA and the marketplace is responding to the informal opinion letters issued by HUD.

TESTIMONY OF THE
NATIONAL ASSOCIATION OF REALTORS®
BEFORE THE
SUBCOMMITTEE ON HOUSING AND URBAN AFFAIRS
OF THE
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS
U.S. SENATE
SEPTEMBER 19, 1990

INTRODUCTION

Mr. Chairman, Members of the Subcommittee, my name is Norman D. Flynn. I am a REALTOR® from Madison, Wisconsin and the 1990 president of the NATIONAL ASSOCIATION OF REALTORS®. On behalf of the 800,000 members of the NATIONAL ASSOCIATION OF REALTORS®, I would like to thank you and the Members of the Subcommittee for this opportunity to present the views of the NATIONAL ASSOCIATION OF REALTORS® regarding the Real Estate Settlement Procedures Act (RESPA), particularly the issues surrounding REALTOR® involvement in the mortgage origination and settlement process.

My testimony will provide (1) an overview of the issues related to REALTOR® involvement in the mortgage origination and delivery process; (2) an historical background of the evolution of the mortgage delivery system and REALTOR® involvement in the same; (3) consumer benefits derived from REALTOR® involvement; (4) a legislative and regulatory background on RESPA and development of implementing regulations; (5) a summary of NAR's development of policy with respect to RESPA; (6) discussion of RESPA issues relevant to REALTORS®.

OVERVIEW – THE TRUE ISSUE

For the last two years, the NATIONAL ASSOCIATION OF REALTORS® has been defending the right of its members to be remunerated for providing customers and clients with real estate-related services associated with the brokerage function. In spite of the fact that the Real Estate Settlement Procedures Act (RESPA) clearly allows payments for services rendered, some in the industry are challenging the applicability of that legislation to REALTORS® involved in the mortgage origination process. This situation arose because of two reasons: (1) HUD's failure to prosecute violations being perpetrated by certain mortgage brokers who were attempting to remain competitive by paying illegal referral fees; and (2) the advent of computerized loan origination programs and the technological evolution of the mortgage delivery system. In the name of fighting illegal referral fees, opponents of NAR's position have played off of historical fears about consumer abuses experienced prior to the enactment of RESPA and have attempted to shut out a viable competitor -- REALTORS® -- in the mortgage business.

The issue is **not referral fees** or kickbacks. NAR agrees that **payments to real estate brokers and agents for simple referrals -- WITHOUT ANYTHING MORE -- are illegal** under current **law and should continue to be illegal**. HUD can shut down illegal referral fee abuses by enforcing **existing law. The true issue** is the right of REALTORS® to be paid a fair price for additional **mortgage-related services** they provide to customers, particularly those who are involved in usage of new computerized loan origination (CLO) systems. Even more important is the potential negative effects of limiting REALTOR® compensation to brokerage services. For years, real estate brokers have been providing a full range of real estate-related services associated with the sale and purchase of a home. It is imperative that their ability to continue to do so not be restricted by anti-competitive, protectionist legislation or regulation.

EVOLUTION OF THE MORTGAGE ORIGINATION AND DELIVERY SYSTEM

In the last two decades, technological change in the methods used to produce and distribute credit in U.S. mortgage markets has been extraordinarily rapid and wide-ranging. At the same time, changes in the regulatory environment and the development of the secondary mortgage market have led to a proliferation of mortgage products from which a borrower may choose. Prior to the authorization of adjustable rate mortgages in 1981, there had been almost no mortgage product differentiation other than price (interest rate). The primary choice was between a conventional or government (FHA, VA, FmHA) loan. The new marketplace created a need for a class of individuals who could help the home buyer understand product options, shop for a mortgage loan and, ultimately, place the loan with an institutional lender.

In the early 1980s, mortgage brokers filled this role, interpreting the terms of new mortgages for consumers. Mortgage brokers work for lenders, selling the products of the lender by whom they are employed. Mortgage brokers are typically paid one-half a point (0.5 percent) of the amount of the mortgage by the lender. However, this amount may vary depending upon the loan product and lender.

By the close of the decade, technology had evolved to a point where consumers could obtain the same assistance from computerized loan origination systems operated out of their real estate broker's office. Ironically, by the year 2000, technology may eliminate the need for any intermediaries between consumers and sources of mortgage funds as systems become more user-friendly and generations raised on personal computers become potential home buyers.

THE LOAN PROCESS

There are basically six steps in the residential loan origination process: (1) application taken by the loan originator; (2) assembling and processing the loan file; (3) underwriting; (4) loan funding; (5) sale to investors or placement in the financial institution's portfolio; and (6) servicing of the loan.

In general, the computerized loan origination systems in place or envisioned entail an employee of a real estate broker functioning in the capacity of a loan originator -- the person completing the first steps in the mortgage process. The services associated with this part of the process include advising the buyer about various mortgage products, taking and submitting the mortgage application, and following up with regard to the mortgage application by tracking it until a loan commitment has been received.

For borrowers, apart from loan closing and funds disbursal, loan origination is the most critical stage of the mortgage process. Until recently, the application process has been paper-based and highly labor and time intensive. Computerization has made the mortgage process more efficient, separating the functions of originating, servicing and funding mortgage loans. While the benefits to both consumers and lenders are substantial, "unbundling" the services associated with each function has resulted in an extended range of players competing for the right to perform them. It is this battle for market share that brings us here today.

Real estate licensees are playing an increasingly important role in the mortgage process. They are the point of personal contact for borrowers utilizing computerized loan origination (CLO) systems, eliminating one or more extra steps in the process of shopping and negotiating for a home loan. These systems offer real estate brokers/agents the chance to meet consumer expectations for the convenience of "one-stop shopping" and more immediately respond to home buyer requests for assistance throughout the mortgage process. In the past, this convenience did not exist, and home buyers had to leave the real estate broker's office to find financing. In the old days, that meant finding a lender through the usual hit-or-miss channels, which included relying on newspaper advertisements or the recommendations of real estate agents confined to lenders with whom they had had personal experiences. Today, CLO systems provide up-to-date information about the products of several lenders without having to leave the broker's office and without having to engage a loan broker/officer to start the origination process.

COMPUTER LOAN ORIGINATION (CLO) SYSTEMS

A computerized loan origination system (CLO) involves the placement of a computer terminal in a broker's office. It provides information about the loan products offered by one or more lenders. It can also be used to pre-qualify borrowers and transmit mortgage applications. Buyers are assisted in the application process by the system operator. Today, there are a few national systems, but as the technology becomes less costly, regional and local systems will emerge tailored to the specific needs of individual real estate markets. The CLO systems of the future will be open to as many lenders as the system can accommodate, which essentially is unlimited. The only reason for excluding lenders will remain negative experiences with a lender's performance during the funding process or in the servicing of the mortgage loans.

The market development of CLO systems is similar to the development of Automated Teller Machines (ATMs). In the early stages of the ATM market, several area banks started independent systems which only the bank's customers could access. In a short time, the area banks entered into joint ventures or agreements with other area banks so that a bank's customers could use any ATM in the system, not just the ATM machines operated at the customer's bank. If the market for CLO systems is permitted to take a natural evolutionary process, we believe the same multi-institution access will develop.

Computerized loan origination systems extend the concept of multiple listing services for houses to the realm of mortgage finance. They forge new links between home buyers and mortgage originators. They enable real estate brokers and their agents to keep up with the literally hundreds of basic combinations of loans available to fulfill the needs of their clients and customers. This information can be changed instantaneously in response to minute-to-minute changes in the mortgage markets which lenders must make to remain competitive. This is a far cry from "the old days" when mortgage lending rates and products were fairly standard for months and years at a time.

CLO systems provide rural areas served by one, perhaps two, financial institutions with the mortgage products of national lenders, bringing much needed competition to these markets and increased choices for consumers. They are also useful during periods of high interest rates when lenders are less willing to negotiate mortgage rates and, in fact, withdraw from certain markets altogether. This was the experience in Ohio, where the CLO system developed by the Ohio Association of REALTORS® in the early 1980s increased mortgage competition and lowered rates.

Computerization enables lenders to turn around loan applications in as little as a few days when the average time a homebuyer waits for a decision on a loan processed manually is more than 30 days. The introduction of streamlined processing has forced all lenders to improve upon their turn-around time. For consumers, for whom a simple, fast process is of tantamount importance, the "coming of age" of the mortgage delivery system has been long overdue. Streamlined processing lowers transactional costs of obtaining a mortgage through reduced points, fees, interest rates, or some combination of these. A reduction of a quarter point in these transaction costs, which is a reasonable estimate of consumer savings, translates into approximately $6,000 over the life of the loan.

CONSUMER BENEFITS THROUGH REALTOR® INVOLVEMENT IN CLO SYSTEMS

The list of benefits to consumers as a result of the computerization of the mortgage process is extensive:

- Real estate brokers and agents who use CLO systems can create competition among lenders. CLO systems allow real estate brokers to access mortgage markets outside their own geographic area. Local lenders are forced to compete with national lenders which can mean lower mortgage rates for consumers.

- Consumers benefit from the efficiencies of a computerized mortgage process. Streamlining the process has forced all lenders to accelerate the application process in order to remain competitive. Being able to receive quicker commitments from lenders relieves a considerable amount of the stress consumers normally experience with the mortgage process. Speed of processing enables real estate licensees to take the information necessary for the mortgage application, input it into the computer and immediately transmit it to the lender.

- CLO systems provide borrowers with up-to-date information on interest rates and programs of various loan products. Unlike rate sheets, which may be provided weekly, the CLO can provide up-to-the minute and accurate information.

- If the buyer does not obtain a mortgage commitment from the lending institution to which he initially applies, under a CLO, he is more likely to be able to submit a second application within the mortgage commitment time period without forfeiting the sale.
- Under many CLO systems, the buyer can submit applications to multiple lenders simultaneously thereby increasing the odds of receiving a commitment.
- CLO systems decrease the cost of the mortgage application process through economies of scale. Uniform application forms result in a time savings in filling out forms and multiple applications can be generated at a lower cost than is possible filing separate applications.
- CLO systems enable real estate brokers to track the mortgage application more readily.
- CLO systems may be able to reduce lender bias. Computers cannot determine race, creed or color. It would be quite difficult for a lender to practice discrimination observing computer generated data.

Perhaps the greatest consumer benefit of having a REALTOR® assist in mortgage origination is that the cost of these services is often less than the cost incurred when a mortgage broker charges for these same services. Typically, a mortgage broker will receive one-half of a point. Further, the amount varies depending upon the type of mortgage loan he sells. Consumers are rarely informed that there is a difference in the amount a mortgage broker receives, a fact that may influence the types of mortgage product being offered.

CONSUMER SATISFACTION--LACK OF ABUSES

Mr. Chairman, critics of NAR's position contend that REALTOR® involvement in the mortgage origination process has led to untold instances of consumer abuse. In fact, we have found the opposite to be true. For example, the Conference of State Bank Supervisors indicates that none of its 50 state regulators has received any reports of consumer dissatisfaction with real estate brokers/agents who assist borrowers in obtaining financing for a home mortgage. Indeed, **New York State Superintendent of Banks, Jill M. Considine,** in a comment letter dated January 24, 1990, to the New York Secretary of State regarding the latter's proposed regulation to prohibit real estate brokers/agents from providing mortgage-related services to a buyer where the broker/agent **has also represented** the seller in the sale of the property, stated:

> After **almost three years** of experience with this comprehensive regulatory framework [which requires real estate brokers who assist buyers to obtain mortgage financing for a fee to be additionally licensed as a mortgage broker], **we find that regulations have been effective and beneficial to consumers.** We suggest that some industry concern about profitability may be driving an effort to restrict the numbers of those engaged in the mortgage broker industry. **However,**

our regulatory experience has not identified any concerns with real estate brokers who also act as mortgage brokers for a separate fee in a transaction nor have we seen any consumer dissatisfaction. Presently, over 70% of the 2,263 registered mortgage brokers supervised by our Department are licensed real estate brokers or salespersons and **we have had** no **consumer complaints even suggesting that there is a problem, nor have any problems been uncovered by our examiners.**

Many banks have mortgage broker/referral programs that utilize licensed real estate brokers who are registered mortgage brokers, and this practice is growing. **The success of these programs has apparently evoked complaints from industry competitors and lobbying against this practice has also increased in the context of "HUD-RESPA" proposals before the U.S. Department of Housing and Urban Development."** (Emphasis added)

STATE ACTIONS

Several states, including Pennsylvania, Connecticut, Virginia and Michigan have recently considered the issue of the payment of a fee to a real estate broker who provides additional services in connection with the mortgage application process. Generally, all state action has been favorable to the REALTOR® position, although it has been misinterpreted in certain trade publications.

The right of real estate licensees to be compensated for mortgage-related services has been upheld and the following criteria established for payment:

(1) In Connecticut, real estate licensees are required to have a mortgage brokers license to receive compensation for mortgage-related services. Obtaining a mortgage brokers license usually entails payment of a one-time and annual fees and, in some cases, bonding requirements. In most cases, there is no prescribed course work, educational requirements or experience level to be a mortgage solicitor/broker in contrast to real estate licensing requirements.

(2) Pennsylvania has a two-tier concept. Real estate brokers can receive up to $100 (recommended) for mortgage-related services provided as a real estate agent. If the broker wants to charge more, than he will have to obtain a mortgage brokers license. Obtaining a mortgage brokers license entails a $500 initial fee, annual fees of $250, no bonding requirement if no fees are collected before settlement and a $100,000 requirement if advance fees are taken. There are no professional requirements for the license.

(3) In Virginia, a system is in effect under which those real estate brokers who had been providing mortgage-related services before February 25, 1989 can continue to provide those services. However, real estate brokers who were not providing those services before that date are, at least for the present, prohibited from providing them.

(4) In Michigan, real estate licensees do not have to obtain a mortgage brokers license to receive compensation for mortgage-related services if only the broker for which the salesperson is an agent or an employee pays the compensation for the services and they act as a mortgage broker for additional compensation on 10 or fewer mortgage loans in any 12 month period from July 1 to June 30.

The clear trend is to permit the payment of a fee to real estate brokers who provide additional services, although there may be a requirement for a separate mortgage brokers license.

REAL ESTATE SETTLEMENT PROCEDURES ACT (RESPA)

Legislative History

The impetus for passing the Real Estate Settlement Procedures Act (RESPA) takes an interesting path. A series of articles in the Washington Post highlighted financial surprises consumers received at the closing of a real estate purchase. These unexpected payments at settlement struck a nerve with politicians and voters. In addition, in 1972, Congress received a joint report from the Secretary of HUD and the Administrator of the Veterans Administration on mortgage settlement costs which outlined kickbacks, rebates, commissions and inflationary referral fees being paid by title companies to providers of settlement services.

RESPA was enacted in 1974 to provide consumers involved in residential real estate transactions with timely information regarding the nature and costs of the settlement process and to protect them from unnecessarily high settlement costs caused by certain abusive practices (i.e., kickbacks and/or referral fees). Indeed, Section 2601 of Title 12, United States Code, reflects the Congressional purpose in enacting RESPA which states that "the purpose of this chapter [is] to effect certain changes in the settlement process for real estate that will result . . . in the elimination of kickbacks or referral fees that tend to increase unnecessarily costs of certain settlement services." By "kickbacks" and "referral fees", Congress meant fees for the simple referral of business -- without any services rendered. It is this practice that has always been illegal because the fees are passed on to consumers in the form of hidden costs. The MBA contends that fees to REALTORS® for helping borrowers obtain financing are "referral fees". We maintain that the fees are payment for services rendered, and that there is no difference between mortgage services provided by real estate brokers through CLO systems and those provided by mortgage solicitors/brokers.

RESPA was amended in 1983 to establish an exemption for controlled business arrangements. Again, Congressional intent was to prohibit payment for simple referrals within these companies and to provide guidelines for the provision of settlement services by vertically integrated financial services firms as well as between franchisor and franchisee.

Regulatory History -- HUD's Two Rules

In May of 1988, HUD proposed regulations implementing the 1983 legislation. One provision provided for "... voluntary payments by a borrower to a person who has acted as a mortgage broker or has otherwise assisted in bringing the lender and borrower together...". The proposed language reflects opinion letters issued by HUD's Office of General Counsel on the legality of payments to individuals participating in computerized loan origination programs.

The letters fall in one of two categories: (1) lender pay systems or (2) borrower pay systems. In a typical lender pay situation, the CLO is owned by a third party and operated in a real estate broker's office by a financial services representative or an employee of the brokerage operation. The lenders make payments to the CLO system operator in the range of $400 to $500 per transaction. A portion of that fee is passed on to the real estate broker or financial services representative. The fee to the real estate broker is generally $100 - $250 to compensate for operator time and expense. There is no payment made by the lender to the real estate broker or by the borrower to the real estate broker. (**See** HUD legal opinion letter to Prudential Real Estate Affiliates which describes a lender pay system in compliance with RESPA, attached as **Appendix A**.)

In the typical borrower pay CLO system, the real estate agent and home buyer sign an agreement that lists the services the agent will provide the borrower and the fees to be charged. Under a borrower pay program, real estate brokers (attorneys or other financial services representatives) explain the product of one or more lenders and take the initial application which is then sent electronically to the lender's processing center. The application is then processed, credit reports and title reports are ordered, verifications are checked, and the loan is packaged for lender underwriting determinations. (**See** HUD legal opinion letter to Citicorp Savings which describes a borrower pay system in compliance with RESPA, attached as **Appendix B**.)

The May, 1988 rule wculd have codified these legal opinions and are supported by the National Association of REALTORS®.

Purported Final Draft RESPA Rule

In late December 1988, a copy of what was purported to be a draft of final RESPA regulations was leaked to the press. This version, which had not undergone the standard review and approval process required by HUD for the promulgation of regulations and, therefore, was not an official document, would have prohibited the fees involved in some CLO programs and prohibited real estate brokers/agents from receiving remuneration for services rendered in connection with the loan origination process. The "rationale" for this position was that real estate agents already receive one fee on the transaction and, therefore, are not entitled to any others. This "draft" ignored legislative intent in that Congress authorized payments "for services rendered". Further, there was no intention to artificially segment the settlement process to protect the market share of any one industry.

The NATIONAL ASSOCIATION OF REALTORS opposed the purported draft "final" regulations which were leaked to the press in December 1988. The "draft" would have reversed HUD's earlier policy position and prohibited real estate brokers/agents from receiving fees for origination programs for reasons that were not grounded in the statute (RESPA). NAR cited the following reasons in support of its opposition to the "draft" final rule:

- The mortgage-related services REALTORS® provide home buyers are legitimate. They include, but are not limited to, advising the buyer about various mortgage products, taking and submitting the mortgage application, and following up with regard to the mortgage application by tracking it until loan commitment has been received.

- Restricting the income of real estate brokers involved in computerized loan origination systems will adversely affect the development of new loan products and streamlined procedures that benefit consumers. Consumers are demanding that brokers provide an expanded range of real estate-related services. They expect real estate brokerage firms to offer them assistance throughout the mortgage process. Developments in computer technology have enabled brokers to provide loan services at the point of sale, but systems cost money. Examples of these additional costs include:

    - the computer hardware and software;
    - the dedicated computer telephone line hook-up;
    - the telecopy machine that must be made available exclusively for the CLO;
    - the cost of space dedicated for the computer loan operations;
    - the salary of the person who operates the CLO;
    - long distance telephone lines, federal express costs, and similar additional costs incurred by the real estate broker.

- It has been suggested that the expenses incurred by a real estate broker for participating in a CLO should be absorbed by the firm. If the broker is not compensated for these expenses, the small margin of profit to the broker from the real estate sales commission will virtually foreclose a smaller real estate broker's office from providing these services. The competitive ramifications of the inability to provide such computer technology are apparent. The smaller real estate broker ostensibly will be foreclosed from the market if he cannot offer the services; yet he will be unable to do so if the costs cannot be covered in his profit margin.

The HUD "draft" final rule also would have prevented real estate brokers from receiving fees for CLO services because they received other compensation on the transactions processed and closed on the system. In other words, prohibiting REALTORS® in this manner would effectively enable another industry to control the mortgage loan origination process in spite of the existence of a more efficient means of delivering services to the consumer.

NATIONAL ASSOCIATION OF REALTORS® DEVELOPMENT OF RESPA POLICY

Background

In September of 1988, NAR President Nestor Weigand appointed the Real Estate Settlement Procedures Act (RESPA) Task Force to examine the issues raised by the proliferation of loan referral arrangements, computerized loan origination systems, controlled business arrangements and other questions raised by the RESPA regulations.

At the time NATIONAL ASSOCIATION OF REALTORS® had policy on RESPA as follows:

"That the NATIONAL ASSOCIATION OF REALTORS® oppose all legislative and regulatory efforts to prohibit or limit the payment of additional compensation for real estate-related services accorded buyers and sellers, including mortgage finance, insurance and other related items, provided such compensation is fully disclosed to the buyer and seller."

This policy supported the payment of fees for real estate related services provided that all such fees are made known to and accepted by the customer prior to settlement. NAR's policy was of long-standing, however, and, needless to say, was being challenged by market arrangements that did not exist at the time of its formulation. In light of new forms of prequalification, point of sale financing and the relationship of some members with national programs like Citicorp Mortgage Power, the Task Force was asked to consider what corrections, modifications or other changes need to be made in Association policy on RESPA. These recommendations were to be made within the context of currently proposed regulations, pending legal actions and potential legislation.

Key to the task force discussions was HUD's language in the May, 1988 rule permitting payments for "bringing the borrower and lender together". There was concern that these could be construed as "naked" or "simple" referral fees. The goal was to clarify NAR policy about fees received for participation in national loan programs and payment for referrals within controlled business arrangements.

Task Force Conclusions

(1) The Task Force concluded that computerized loan origination programs which allow real estate brokers/agents to provide homebuyers with mortgage-related services are a positive development for all parties concerned. They enable real estate brokers to provide consumers with point of sale financing at what is often a cost savings for consumers. Fees charged for CLO services offset costs incurred by brokers for installing and operating the systems. If real estate agents receive fees in connection with a lender program, they must be based on actual work performed for the borrower rather than the referral of the borrower's business.

(2) Within controlled business arrangements, as statutorily defined, the Task Force upheld its policy recommendation in opposition to payment for simple referrals within this corporate structure.

The Final Policy

Adopted by the Board of Directors, February 6, 1989:

> Where a real estate broker/agent provides services in addition to or different from those he/she is obligated to provide by his/her agency agreement, that broker/agent is entitled to remuneration for these services, provided that full and written disclosure is made to and accepted by all clients and customers to the transaction in advance of undertaking to perform such services. The NATIONAL ASSOCIATION OF REALTORS® is opposed to the acceptance of fees by real estate brokers/agents for the simple referral of customers or clients to mortgage lenders and providers of other settlement related services. (emphasis added)
>
> In controlled business arrangements, as defined by the RESPA statute, the NATIONAL ASSOCIATION OF REALTORS® believes that brokers/agents are entitled to remuneration for the delivery of real estate related services provided that written disclosure (which is not unduly burdensome) is made to and accepted by all clients and customers to the transaction; and there is no required use of these services.
>
> The NATIONAL ASSOCIATION OF REALTORS® is opposed to legislative or regulatory efforts to limit the payment of remuneration for these additional services.

CONTROLLED BUSINESS ARRANGEMENTS

A significant percentage of NAR members provide more than one settlement service. As Congress defines it, many of them constitute controlled business arrangements, having a 1% ownership interest in supplier-owned real estate companies. The NATIONAL ASSOCIATION OF REALTORS® believes that a real estate broker/agent in a controlled business arrangement should be allowed to give or receive payment for services rendered provided full disclosure is made to and accepted by all parties to the transaction, and no customer is required to use a particular provider of settlement services. Shareholder referrals should not be limited in these arrangements as long as shareholders do not receive returns based on the volume of referral activity.

Congress determined that controlled business arrangements produce significant consumer benefits and exempted them from RESPA, provided certain conditions are met. Real estate brokers from large, medium and small shops have begun to see the need to bundle services in order to compete, either by acquiring ancillary service companies or by forming joint ventures with these companies. It is important that the real estate brokerage industry be able to continue to expand to meet the needs of the marketplace. The position of the MBA and the language in the purported final HUD regulations (December 1988) would unduly limit the business activities of real estate brokers who wish to provide ancillary settlement services through controlled business arrangements.

AGENCY/CONFLICT OF INTEREST

Mr. Chairman, the NATIONAL ASSOCIATION OF REALTORS® notes that there is some confusion about the agency status of the real estate broker/agent vis-a-vis the real estate seller and the real estate buyer. In fact, much of the controversy over real estate broker/agent performance of mortgage services for borrowers is predicated upon the erroneous assumption that helping the borrower obtain financing violates the agent's agency agreement with the seller.

An agency relationship is a fiduciary relationship. As a fiduciary, a real estate broker owes certain specific duties to his principal in addition to duties enumerated in the listing contract or other contracts of employment. These duties include loyalty, obedience, and the exercise of care and diligence in pursuing the principal's affairs. More specific examples of these general duties include a duty to reveal to his principal all relevant information pertaining to the scope of the agency. For a real estate broker, this duty encompasses disclosure to a principal seller of the existence of all offers to purchase the property, the identity of all offerors, and the financial capacity of potential buyers. Listing agents and selling agents (sub-agents) have not been found to represent a buyer when all they did for the buyer was show the buyer property, describe generally the attributes and amenities of the property and available types of financing, and present the buyer's offer to the seller. This type of conduct is generally viewed as an ordinary marketing function undertaken ancillary to the broker's agency agreement with the seller.

Generally, the listing and cooperating ("selling") brokers are the agents of the seller; however, a buyer can choose to have a real estate broker/agent represent him in a transaction. Legally, assisting the buyer in obtaining financing does not compromise the real estate agent's agency agreement with the seller. The terms of this agreement are fulfilled once the agent brings a willing and able buyer to the table. Further, helping the borrower through the mortgage process does not mean that an additional agency relationship exists unless the real estate agent contracts to represent the borrower in the same transaction. If the buyer chooses to have a real estate broker/agent represent him instead of, or as well as the seller, he must:

1) Enter into a written contract that clearly establishes the obligations of both parties; and

2) Specify how the agent will be remunerated.

Critics of loan referral programs contend that a broker/agent who receives fees from certain lenders will not find the best financing possible for their buyer. The NATIONAL ASSOCIATION OF REALTORS® believes that it is in the best interest of the REALTOR® to find the borrower the best product because real estate brokers/agents rely on the return business of satisfied clients and customers to succeed. Sacrificing the borrower's needs for referral fees would irrevocably damage a broker/agent's reputation with his/her peers and customers.

Critics of REALTOR® involvement in the mortgage origination process contend that a conflict of interest occurs when REALTORS® assist buyers. Once the contract between the seller and the buyer has been signed with regard to the sale of the real estate, the contractual obligations of the agent to the seller are fulfilled. At this time, helping the borrower obtain financing is in the best interest of all parties.

The NATIONAL ASSOCIATION OF REALTORS® believes that full and written disclosure made to and accepted by all clients and customers to the transaction in advance of undertaking to perform such services protects all parties from problems associated with conflicts of interest. The NATIONAL ASSOCIATION OF REALTORS® has provisions in its Code of Ethics and Standards of Practice to this effect. (See Article 7, Standards of Practice 21-12, 21-13, attached as **Appendix C**.)

Potential conflicts of interest are indigenous to the brokerage function. The potential conflict is ameliorated, if not eliminated altogether, through upfront disclosure. This is a satisfactory mechanism for such regulatory oversight bodies as the Securities and Exchange Commission, which has always relied on disclosure and the conscious effort of the professional to inform the consumer.

NATIONAL ASSOCIATION OF REALTORS® POSITION ON VARIOUS RESPA ISSUES

HUD PROPOSED RULE

The NATIONAL ASSOCIATION OF REALTORS® strongly supports the proposed rule issued by the Department of Housing and Urban Development (HUD) on May 16, 1988. It confirms interpretive rulings issued by HUD's Office of General Counsel on the legality of computerized loan origination systems and the right of real estate licensees to receive remuneration for real estate-related services. NAR supports the right of brokers/agents to participate in loan referral programs if they perform services in addition to or different from those they are obligated to provide by their agency agreement with the seller.

COMPENSATION FOR WORK PERFORMED

Critics of REALTOR® involvement in the mortgage origination process challenge the payment of a fee for the performance of mortgage-related services to a real estate broker/agent who is otherwise compensated in the transaction, primarily on the basis that the commission should cover all services provided the seller and the buyer even if they go beyond those enumerated in the agency agreement with the seller. If a real estate broker/agent, after having met the requirements of his/her agency agreement with the seller, performs services for the borrower related to the obtaining of a mortgage loan and the loan origination process, he/she is entitled to additional remuneration for that work.

The marketplace today is very different from that of a decade ago. In the real world of operating a residential brokerage office in an effective manner, real estate agents continually monitor the mortgage market as to rates, products, underwriting, special terms and other features of paramount concern to borrowers. Real estate brokers/agents who choose to perform financial counseling or loan processing services should, however, enter into a written contract with the borrower that clearly establishes the obligations of both parties and specifies how the agent will be remunerated.

CONTROLLED BUSINESS ARRANGEMENTS

Controlled business arrangements, as defined by RESPA, are not just financial institutions and their subsidiaries or large real estate brokerage companies owned by corporations. A threshold of a 1% ownership interest constitutes a controlled business arrangement, which captures many NAR members. Since 1983, when Congress first addressed the issue, real estate brokers and other providers of settlement services from large, medium and small shops have begun to see the need to provide consumers with more than one settlement service, if not by acquiring ancillary service companies, then by forming joint ventures with these companies. It is important that the real estate brokerage industry be able to continue to expand to meet the needs of the marketplace. HUD's purported "final" regulations would limit the business activities of real estate brokers who wish to provide ancillary settlement services through a controlled business arrangement.

If the MBA position prevails, every industry involved in real estate transactions will move to limit the business activities of real estate practitioners. REALTORS® would be unable to receive fees for ancillary services such as title insurance, home warranty protection and escrow; although such a limitation was never contemplated by Congress.

RESPA AND BANKING

The current controversy over real estate broker/agent participation in loan referral programs has generated questions about the NATIONAL ASSOCIATION OF REALTORS® policy on expanded powers for banks. The NATIONAL ASSOCIATION OF REALTORS® opposes allowing banks into the brokerage business because they benefit from the real and perceived benefits of federal protection.

There should be no question that a real estate broker or salesperson providing mortgage-related services in connection with a CLO would not be originating loans. The real estate broker or salesperson would not be funding any such loan or issuing any commitment with regard to any such loan. The real estate agent merely would be providing services as part of the pre-commitment phase of the mortgage application process. The lender would provide the funding.

The increased involvement of the real estate broker/agent in the loan process is a result of innovations in the marketplace that have raised consumer expectations about the ability of the broker/agent to provide access to lenders and their products from the broker's office.

CONCLUSION

Mr. Chairman, the real estate industry is a growing industry and requires a revolution in mortgage lending to handle that growth. By the year 2001, there will be a demand for $1.4 trillion in mortgage money. Seven to ten million more people will be buying homes. The preferences of these home buyers will also increase the need for alternative mortgages and for real estate brokers/agents who can take the buyer quickly and knowledgeably through every step of the real estate transaction.

In our view, the current RESPA controversy is a fight by some mortgage lenders to retain their position as the chokepoint for the delivery of mortgage origination services. The alleged complaint against real estate agents is the receipt of "naked" referral fees. The NATIONAL ASSOCIATION OF REALTORS® has policy opposing these illegal fees and advocates punishment for violating the law. Current law provides adequate mechanisms to weed-out mortgage brokers who are offering referral fees and real estate agents who are accepting them. However, homebuyers will not be served and the market will be forced to operate inefficiently if current law is changed to prohibit real estate licensees who provide legitimate mortgage-related services from receiving compensation for their efforts.

With the rapid technological development of the personal computer, new ways of delivering the range of settlement services – mortgage origination, escrow, title and other services – will continue to evolve. CLO systems promise to revolutionize not only the mortgage origination process but all aspects of the home purchasing. The NATIONAL ASSOCIATION OF REALTORS® supports the right of its members to receive remuneration for services rendered in connection with the mortgage process.

If Congress allows one industry to define its competition, what will stop others from following suit? Precluding REALTORS® from being compensated for mortgage-related services (mortgage finance, escrow, title search and insurance) presently being offered to home buyers and sellers will not only harm REALTORS® but could potentially increase costs to consumers in areas that cannot support stand-alone service providers.

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON D C 20410

THE GENERAL COUNSEL

APPENDIX A

April 24, 1986

HUD Approval Letter for
Borrower-pay CLO System

Jeremiah S. Buckley, Esq.
Thacher Proffitt & Wood
1140 Connecticut Avenue, N.W.
Washington, D.C. 20036

Dear Mr. Buckley:

This is in response to your letter of March 26, 1986, and our meeting of March 25, 1986, with you and Len Druger and Tim Wahl of Citicorp Savings. You have requested a written informal opinion regarding the legality under Section 8 of the Real Estate Settlement Procedures Act of 1974, as amended ("RESPA") (12 U.S.C. §2607) of a proposed mortgage origination program (the "Program"). It is our opinion that the Program does not violate Section 8 of RESPA.

Based upon your letter and our discussion, we understand that under the Program, mortgage brokers, real estate brokers or attorneys (the "Participants") are authorized, but not obligated, to introduce borrowers to the products and features of the Program, including "jumbo" loans, reduced origination points and priority processing, and to arrange for borrowers to apply for loans from Citicorp. It is our understanding that none of these loans will be FHA-insured. Participants explain Citicorp's products and terms, and may aid the borrower in completing the mortgage application, follow up to assure customer satisfaction and generally assist the borrower in the origination process. The Program will not be offered directly by the banking offices of Citicorp, but only through the Participants. Citicorp will advertise the Program and list all Participants in the market area in which the advertising appears. Under the Program, Participants will pay Citicorp a fixed annual enrollment fee, currently set at $2,500. The enrollment fee would not vary based upon the volume of activity of the Participant and may be reduced for minority Participants. The Participants will receive no payment from Citicorp for their Program activities. Where permitted by State law, the Participants may be paid directly by the borrower for services rendered.

For purposes of this opinion, it is assumed that the service provided with respect to the loan application for Citicorp by the Participant is a "referral" of "business incident to or a part of a real estate settlement service" within the meaning of Section 8(a) of RESPA. 12 U.S.C. §2607(a).

No question of violation of Section 8(a) is raised by the payment of the enrollment fee by a Participant to the lender, for the obvious reason that the payment goes in the wrong direction. The payment, therefore, cannot be considered in any way compensation by the lender for a referral. Instead, it is a payment by the Participant to secure the benefits of the Program for customers and potential customers of the Participant. Nothing in RESPA casts doubt upon the validity of a payment made for such a benefit. In principle, it is no different from the builder bulk commitment fee described in my earlier opinion letter, addressed to you, dated March 4, 1986. (No question was raised there about the commitment fee paid by the builder; the opinion addressed only the separate aspect, not present here, of the returnability of the commitment fee under certain circumstances.) I also note that the enrollment fee is not based on "referrals" in any case; it is a fixed fee which will not vary based upon actual volume of activity.

Neither is any question of violation of Section 8(a) raised by the payment of a fee to the Participant by a borrower. We have previously held that the payment of a fee by the borrower to the broker, as a result of a direct arrangement between the mortgage broker and the borrower and not as a result of any requirement imposed by the lender, is outside the prohibitions of Section 8(a). HUD informal opinions, D. Alexander, October 2, 1984 (enclosed); J. Knapp, April 11, 1986 (enclosed). These holdings are applicable to payments by borrowers to Participants under the Program.

As indicated, some or all of the products and features offered through the Program may not be available outside the Program. The Program will not be offered directly by the banking offices of Citicorp but only through Participants. However, the Program will be available to a broad range of Participants, none of whom will have rights that are exclusive in any way. If customers inquire about the Program at an office of Citicorp, they may be supplied with a pamphlet explaining the Program and listing all Participants in the market area. Citicorp also will list all Participants in the area in any advertising of the Program which Citicorp may publish.

The activities of the Participant may be regarded, at least in some instances, as "the handling of processing" and, accordingly, may constitute a "settlement service" as defined in Section 3(3) of RESPA. However, we do not view the possible advertising or pamphlet distribution by Citicorp as constituting a "referral" to a Participant because of the non-exclusive nature of the listing of Participants that will appear in each. Therefore, we also do not consider that the enrollment fee is paid by the Participant "pursuant to any agreement or understanding" that referrals to the Participant will occur.

We also find no potential violation of the fee-sharing prohibitions of Section 8(b) of RESPA (12 U.S.C. §2607(b)). Assuming, for purposes of this opinion, that the activities of the Participant constitute the "rendering of a real estate settlement service" within the meaning of Section 8(b), it is not reasonable to view the enrollment fee paid to the lender as a "split" of the fees paid to Participants by borrowers. As indicated above, the enrollment fee is fixed, not contingent either in obligation or amount on the receipt of compensation by Participants from borrowers. Further, the enrollment fee, as also stated above, is a payment to secure the benefits of the Program for the customers of the Participant, and therefore may be considered payment "for services actually performed" within the meaning of Section 8(b). See 24 CFR 3500.14(e).

Your letter indicates that the Participant's fee will be disclosed to Citicorp so that it may be included in the proper disclosure forms at settlement. In subsequent discussions, you indicated that Citicorp will prepare the good faith estimate of settlement costs and the HUD-1 uniform settlement statement and will disclose the Participant's fees on both of these disclosure forms. You also indicated that the Participant's fee, if any, will be paid and will be paid by the borrower directly to the Participant. Based on these facts, we suggest that the Participant fee be listed on one of the blank lines in the 800 Series of the HUD-1 (and reflected consistently in the good faith estimate) and, where appropriate, marked "P.O.C." for "paid outside of closing." We also suggest that a disclaimer be added to the good faith estimate form, in substantially the following language:

> NOTICE: A mortgage broker fee in the amount of $______ is listed in the above estimate (Line _____) on the basis of information furnished by ______________.
> (Participant)
>
> Pursuant to the Consumer, Agency and Fee Agreement you have signed, this fee will be paid directly to the ______________ and is not
> (Participant)
>
> imposed by or paid to the __________.
> (Lender)

This is not an official interpretation within the meaning of Section 19(b) of RESPA and, accordingly, does not provide protection from liability (see 24 CFR 3500.4).

Sincerely,

John J. Knapp
John J. Knapp
General Counsel

Enclosures

[illegible]
WASHINGTON D.C. 20410-0500

OFFICE OF THE GENERAL COUNSEL

April 11, 1986

James A. Brodsky, Esquire
Weiner, McCaffrey, Brodsky
& Kaplan, P.C.
1350 New York Avenue, N.W.
Suite 800
Washington, D. C. 20005-4797

Dear Mr. Brodsky:

This is in response to your letter of March 25, 1986 and our meeting of March 24, 1986. You have requested a written informal opinion regarding the legality under Section 8 of the Real Estate Settlement Procedures Act of 1974, as amended (RESPA) (12 U.S.C. §2607) of a proposed arrangement where borrowers pay a mortgage broker fee at settlement to the lender who in turn remits the fee to the mortgage broker.

Based upon your letter and our discussions we understand that under the proposed arrangement, a national mortgage lending company ("Company") makes federally related mortgage loans as that term is defined under Section 3 of RESPA (12 U.S.C. §2602(1) and the RESPA Regulation at 24 CFR §3500.5(b)). The Company proposes to use independent mortgage brokers to take loan applications and complete underwriting packages. The Company will fund and close these loans. The Company would advise participating mortgage brokers of the Company's required net yield for a loan (i.e., the interest rate and discount points). The mortgage broker would be permitted to negotiate with each borrower for a fee for his services in locating a suitable mortgage lender. At settlement, the Company, for the convenience of the parties, would collect any fees that the mortgage broker was able to negotiate with the borrower and remit the fees in full to the mortgage broker. The amount of the mortgage broker fees would be disclosed by the Company to the borrower as part of the good faith estimate required by Section 5(c) of RESPA (12 U.S.C. §2604(c)). The proposed disclosure would state that:

NOTICE: Please be advised that in addition to
the $_______________ in loan discount points
paid to __________________, we have been
Mortgage Lender
advised that in accordance with your
negotiations with _______________,
Mortgage Broker
_________________ shall remit $____________
Mortgage Lender
for a mortgage broker fee from your funds at
settlement to _______________ for services
Mortgage Broker
rendered in connection with your loan.

The borrower would sign this disclosure, and it would be retained by the Company.

For purposes of this opinion, it is assumed that the referral by the mortgage broker to the Company is a "referral" of "business incident to or a part of a real estate settlement service" within the meaning of Section 8(a) of RESPA, and that the mortgage broker fee is a charge for the "rendering of a real estate settlement service" for purposes of Section 8(b) of RESPA.

We have previously issued an informal opinion addressing a similar situation. See HUD Informal RESPA Opinion, D. Alexander, October 2, 1984 (enclosed). In that opinion, we distinguished between lender payments to mortgage brokers for referrals and voluntary payments by the borrower to a mortgage broker. We concluded that such borrowers' agreements which were not a condition of the loan or any other settlement service would not violate Section 8 of RESPA.

Your proposal presents a slight variation from the previous opinion because the Company will be collecting the mortgage broker fee and remitting it to the mortgage broker. We believe that the mechanical function performed by the Company does not constitute a Section 8 violation because the Company is only facilitating delivery of the fee to the mortgage broker who will not be present at closing. We agree with your analysis that the fee received by a mortgage broker in connection with the arrangement described above is a fee paid voluntarily by a borrower for locating and obtaining a mortgage loan and not a fee paid by the Company for the referral of mortgage loan business to it. We also agree that the voluntary mortgage broker fee cannot be considered a condition imposed by the Company for obtaining a mortgage loan from the Company. Also, since the fee is not being "charged" by the Company but is merely being collected by it for the account of the mortgage broker, we do not believe that a violation of Section 8(b) is involved.

We believe the proposed disclosure notice mentioned above is a necessary element for this arrangement. The purpose of this disclosure is to assure that the borrower understands that the mortgage brokers fee is not determined as to amount by the Company or required by the Company as a condition of the transaction, and to reconfirm that the fee arrangement is made independently between the borrower and the mortgage broker.

Your letter proposed that the mortgage broker fee be added to the mortgage broker loan discount points. HUD instructions for completing the HUD-1 Uniform Settlement Statement (Section L of the HUD-1 is also a suggested good faith estimate form) describe the loan discount points (Line 802) as a one-time charge by the lender to adjust the yield on the loan to what market conditions demand (See 24 CFR Part 3500 Appendix A and HUD Special Information Booklet). We do not believe that services such as those performed by mortgage brokers should be included in the discount points on Line 802. In discussions subsequent to our meeting, therefore, we have suggested, and you have indicated that your client agrees, that one of the blank lines in the 800 Series (e.g., Line 809) should be used to indicate separately the fee paid to the mortgage broker. Based on these discussions, we have revised the terminology in your letter to refer to mortgage broker fees instead of mortgage broker discount points. It is understood that we express no opinion on the deductibility of the mortgage broker fee from Federal income taxes.

This is not an official interpretation within the meaning of Section 19(b) of RESPA and, accordingly, does not provide protection from liability (see 24 CFR §3500.4).

Sincerely,

John J. Knapp

John J. Knapp
General Counsel

U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, D.C. 20410-0500

OFFICE OF THE GENERAL COUNSEL

OCT 3 1988

APPENDIX B

HUD Approval Letter for Lender-pay CLO System

RECEIVED
OCT 1 [illegible] 1988

Stanley M. Gordon, Esquire
Gordon and Drysdale
610 Newport Center Drive
Suite 700
Newport Beach, CA 92660

Dear Mr. Gordon:

This is in response to your letter dated July 18, 1988 in which you requested an opinion whether a particular arrangement is consonant with the Real Estate Settlement Procedures Act (RESPA) (12 U.S.C. §2601 et seq.) or the RESPA regulations (Regulation X) at 24 CFR Part 3500. HUD's longstanding position that the making of a mortgage loan is a settlement service is restated in 53 FR 17428, Column 3, May 16, 1988 (the proposed Regulation X revision). We conclude that we have jurisdiction over matters raised by your question.

Your July 18, 1988 letter states that The Prudential Real Estate Affiliates, Inc. ("Prudential"), a subsidiary of The Prudential Insurance Company of America, has recently commenced operating as a franchisor of real estate brokerage franchisees nationwide. These franchisees will be independently owned and operated businesses principally engaged in residential real estate activity. A computerized loan origination (CLO) system will be an integral part of the franchise relationship.

The CLO system will be a mechanism for lenders to bring their mortgage products to prospective homebuyers in the sales offices of the franchisees. It is anticipated that the system will typically include as many as six national lenders and three regional lenders per area and will make available a variety of mortgage loan programs. Prospective homebuyers will first be able to use the system to determine which type of loan is most suited to their financial situation (a pre-qualification function). The system will also include a loan application function which will enable the prospective homebuyer to actually generate a loan application, and the system will produce a Regulation X Good Faith Estimate, the Regulation Z Truth in Lending disclosure forms, and, if necessary, a Regulation X controlled business arrangement disclosure form.

Upon completion of the loan application, a communication (currently expected to be a telephone call) will be directed to the lender notifying it of the prospective borrower. The lender will give a preliminary commitment based on the representation by the franchisee that the prospective borrower has generated an approvable application through the system. The CLO system will then directly transmit the application to the lender; a signed application will be dispatched to the lender soon thereafter. The lender will deal directly with the prospective borrower from this point.

The lenders included in the system will pay Prudential, the franchisor, a fee in the range of $450 to $500 per loan application. Prudential will give lenders a credit for those applications which are subsequently denied by the lender or cancelled by the prospective borrower. The flat fees paid to Prudential by each lender are intended to be for the reasonable value of the services rendered and facilities provided related to the CLO system. Franchisees will receive a flat fee from Prudential, not to exceed $100, for each application generated by them on the system as recompense for operator time and expense in pre-qualification and qualification activities. Franchisees will retain a fulltime employee to perform these activities. Prudential will exercise its interior quality control in concert with respective lenders to determine whether applications that are frivolous, incomplete, or otherwise not acceptable for the lender for further processing are being placed in the system. The intent of the payment to the real estate brokerage franchisees is to reimburse costs of services rendered and expenses incurred in operating the computerized loan origination system and dealing with homebuyers. No fees between lenders and franchisees or between franchisees and borrowers are contemplated.

Fees proposed to be paid by lenders to Prudential, the franchisor, and to real estate brokerage franchisees appear to be fees similar in character to fees for "goods or facilities actually furnished" under Section 8(c)(2) of RESPA. In reviewing an analogous arrangement of the Ohio Association of Realtors REAL-FIND program in an October 9, 1984 letter (enclosed), then General Counsel John J. Knapp concluded that while payment for computer time and usage did not fit neatly into the language of Section 8(c)(2), describing "goods or facilities actually furnished", HUD had the general authority to exclude payments which did not appear to be disguised kickbacks or referral fees. He concluded that a $200-$250 payment for computer time was not barred by Section 8. In the program presented here, the payments are for the computer software/hardware system, system upgrading and administration by the franchisor, and system operation by the franchisees. Under this program the prospective borrower is placed in a position to choose an appropriate mortgage loan program and initiate the loan application process from the offices of the real estate brokerage franchisees. Based on the rationale in the October 9, 1984 Knapp letter, we conclude that these payments are not barred by Section 8, so long as there is a reasonable relationship between costs incurred and fees paid. This is particularly important in the case of the fee paid to franchisees; the flat fee for applications generated should not be excessive so as to constitute a disguised referral fee.

The Department has published proposed rules in the Federal Register on May 16, 1988 (53 FR 17424). While your program as described does not appear to violate the principles set forth in the proposed rule, you should be aware that no commitment can be made to the content of the final rule and it could have an adverse impact on your program. Also, we have not considered in this opinion whether the arrangement would be permissible under FHA guidelines.

This opinion represents an unofficial staff interpretation. Reliance on an unofficial staff interpretation does not provide protection from liability under Section 3500.4.

Sincerely,

Mitchell

Grant E. Mitchell
Senior Attorney (RESPA)

Enclosure

APPENDIX C

Selected NATIONAL ASSOCIATION OF REALTOR'S® Code of Ethics and Standards of Practice

CODE OF ETHICS AND STANDARDS OF PRACTICE

- Article 7

In accepting employment as an agent, the REALTOR® pledges himself to protect and promote the interests of the client. This obligation of absolute fidelity to the client's interests is primary, but it does not relieve the REALTOR® of the obligation to treat fairly all parties to the transaction.

Article 20, Standard of Practice 21-12

"The REALTOR®, acting as the agent of the buyer, shall disclose that relationship to the seller's agent at first contact (Cross-reference Article 7*.)" (Approved 5/88)

The REALTOR®, for the protection of all parties, shall see that financial obligations and commitments regarding real estate transactions are in writing, expressing the exact agreement of the parties. A copy of each agreement shall be furnished to each party upon his signing such agreement.

Standard of Practice 21-13

"On unlisted property, the REALTOR®, acting as the agent of buyer, shall disclose that relationship to the seller at first contact. (Cross reference Article 7*.)" (Approved 5/88)

Standard of Practice 21-14

"The REALTOR®, acting as agent of the seller or as subagent of the listing broker, shall disclose that relationship to buyers as soon as practicable." (Approved 5/88)

Statement of

JAMES M. MERRION

Senior Vice President

COLDWELL BANKER RESIDENTIAL GROUP

on behalf of the

COLDWELL BANKER REAL ESTATE GROUP

Before the

Subcommittee on Housing and Urban Affairs

Committee on

Banking, Housing and Urban Affairs

United States Senate

on the

REAL ESTATE SETTLEMENT PROCEDURES ACT (RESPA)

September 19, 1990

EXECUTIVE SUMMARY

Coldwell Banker offers a full array of products throughout the country such as mortgages, homeowners insurance, escrow and title services, home warranties and real estate brokerage.

Coldwell Banker supports open and fair competition among the industries and opposes protectionistic legislation.

The real estate marketplace has dramatically changed since 1974.

- **Consumer demands** have changed.
  - The increase in two-income households and the decrease in leisure time per household cause consumers to want **more convenience**.
  - The proliferation of different types of mortgage products cause consumers to want **more service** from real estate brokers to help them choose.
- **Advanced technology** makes it easier for businesses to respond to changing consumer demands.

The mortgage lending and real estate industries have responded to marketplace changes by developing innovative products and services.

- Mortgage lenders have provided real estate brokers with electronic loan origination systems that offer consumers valuable services, lower costs and greater competition.
- Real estate brokers are expanding products and services by:
  - Investing in additional education and training for their salespersons.
  - Developing contractual relationships with mortgage lenders in order to offer mortgages through electronic loan origination systems.
  - Creating joint ventures, partnerships or affiliations with mortgage companies, insurers, title companies and other service providers ("controlled business arrangements").

The uncertain and restrictive regulatory environment under RESPA stifles the further development of innovative products and services.

- HUD's guidance on what is permitted under RESPA has been confusing and overly restrictive.
- RESPA has been interpreted in a conflicting and confusing manner by the courts.
- In the absence of clear and consistent guidance from HUD and the courts, many states are enacting laws that add layers of restrictions on top of RESPA.

Coldwell Banker's Recommendations to Congress.

- Reject attempts to discourage real estate brokers from expanding their products and services by restricting their ability to be compensated by lenders or homebuyers in providing these services.
- Begin a long-term comprehensive review of today's marketplace with the goal of creating a modernized regulatory structure that would:
    - Allow any provider of real estate services to offer a full array of products in the most cost-efficient manner – whether it be through contractual arrangements, joint ventures, partnerships or affiliations with other providers.
    - Protect consumers against potential abuses by requiring (1) full disclosure by real estate brokers of relationships with other parties to the transaction; and (2) preventing tying arrangements without preventing legitimate discounts on packaged services.

Good afternoon, Mr. Chairman and Members of the Committee. My name is James Merrion, and I am Senior Vice President for the Coldwell Banker Residential Real Estate Group. Today, I represent the Coldwell Banker Real Estate Group, a subsidiary of Sears, Roebuck and Co. and the parent of the Coldwell Banker Residential Group and Sears Mortgage Corporation. We at Sears and Coldwell Banker commend you for holding hearings on the Real Estate Settlement Procedures Act, or RESPA, because we strongly believe the time has come for a comprehensive review of RESPA in view of the significant marketplace changes that have occurred since it was enacted in 1974. I appreciate the opportunity to offer our views on this extremely important issue.

Today, you will hear from witnesses representing real estate brokers and salespersons -- such as the National Association of Realtors -- who want to expand the products and services they offer their customers. You also will hear from a variety of witnesses representing traditional providers of mortgages and settlement services -- such as the Mortgage Bankers Association and the Mortgage Brokers Association -- who want to restrict real estate brokers from offering these additional products and services. Because Coldwell Banker is the parent of both a mortgage banking firm and a residential real estate firm, I represent members of both the Mortgage Bankers Association and the National Association of Realtors.

In fact, I'm in a unique position to share with you the balanced perspective of a company that participates in virtually all the industries affected by RESPA. As you can see from Attachment 1 to my testimony, Sears and Coldwell Banker offer a full range of real estate services to our customers throughout the country -- a broad selection of mortgages through Sears Mortgage Corporation, homeowners insurance through Allstate, Coldwell Banker escrow and title services, Sears home warranties, and residential real estate services through 40,000 Coldwell Banker Residential sales associates in all 50 states. Many of our sales associates offer or plan to offer their customers a partial or full array of mortgage and other real estate services. Often they will choose to offer Sears or Coldwell Banker products. But they also are free to offer products and services of other companies, some of which are represented here today.

COLDWELL BANKER'S GENERAL POSITION

I'd like to begin by emphasizing that Sears and Coldwell Banker strongly believe that Congress should promote open and fair competition among industries, regardless of whether the legislation involves financial services, RESPA, or other issues. We similarly believe that Congress should reject attempts by any particular segment of the industry to protect itself from competition. Protectionist legislation never serves the best interest of the consumer.

COLDWELL BANKER'S RECOMMENDED APPROACH TO RESPA

We also recognize that Congress has the responsibility to protect consumers against potential abuses in any industry. Congress met this responsibility with respect to the real estate settlement services industry in 1974 by enacting RESPA. As you know, RESPA was enacted for two purposes: (1) to provide consumers with better and more meaningful disclosure of real estate settlement service costs; and (2) to protect consumers against unnecessarily high settlement service costs.

Coldwell Banker strongly supports these two goals under RESPA. We also believe, however, that the current regulatory environment discourages firms from developing and offering innovative products and services in today's rapidly changing real estate marketplace -- products and services that could offer consumers more convenience, greater choice and lower costs. Therefore, we not only urge Congress to reject attempts to amend RESPA to protect certain industries from competition, we also strongly urge Congress and the Administration to begin a comprehensive review of RESPA to assure that its original goals can be met without stifling the development of products and services that meet the consumer's ever changing demands and needs.

MARKETPLACE CHANGES SINCE 1974

Since RESPA was enacted in 1974, we at Coldwell Banker have witnessed fundamental changes in the marketplace.

Customer Demands

First, our customers' demands have significantly changed. As you can see from Attachment 2, two-income households increased from 38 percent of the population in 1974 to 47 percent today and is expected to make up 52 percent of total households by 1995. The percentage of women 25 to 54 years of age in the labor force has and will continue to rise dramatically -- by the year 2000, women will account for two-thirds of the increase in the labor force. In addition, as you can see from Attachment 3, the amount of leisure time per household decreased from 28 hours in 1973 to 17 hours per week in 1987.

How do these demographic changes affect our customers' demands with regard to real estate and settlement services? They want more convenience. Many consumers no longer have the time or the desire to go to a real estate broker for brokerage services, a mortgage broker or mortgage lender for a mortgage, a title company for title insurance, and so on down the line. Many consumers want the convenience -- if they so choose -- of purchasing a part or all of these services as a package. As the Federal Trade Commission recognized in 1988 comments to HUD (Attachment 4), consumers want to have the option to weigh the qualities of each real estate service provider with the convenience offered by the purchase of products and services from a single source.

Our customers' demands have also changed as the secondary mortgage market has evolved, which fostered the development of a wider variety of mortgage products than ever before by allowing mortgage lenders to more readily sell their products. Our customers now desire more sophisticated service from our brokers -- whom they have always relied upon for general mortgage information -- in order to help them choose among a vastly greater number of products.

Advanced Technology

The second major change in the marketplace is the increasingly widespread use of advanced technology in home and business. The availability of computers, hotlines, FAX machines, and other technology enable mortgage lenders to expand their markets, lower their costs through increased efficiencies, increase the speed of loan commitment and loan processing, and increase the amount of mortgage and other real estate service information available to the consumer.

INDUSTRY RESPONSE TO MARKETPLACE CHANGES

Both the mortgage lending and the real estate industries have responded to these changes in consumer demand and technology by developing innovative products and services.

Many mortgage lenders, including Sears Mortgage Corporation, find they can enter new markets that otherwise would be too costly to enter by providing real estate brokers with electronic loan origination systems that not only display their loan products and rates but also prequalify and process loans for the brokers' customers. These programs increase competition and consumer choice since these mortgage lenders otherwise wouldn't have entered the market. They ultimately lower costs to the consumer because they provide a means for more lenders to distribute more products more efficiently. And finally, they provide valuable consumer services such as instant affordability analysis, loan comparison, and electronic generation and transmittal of loan documents. For example, Sears Mortgage Corporation offers an "Approval First" process through its electronic loan origination system under which a real estate customer can be preapproved by Sears Mortgage Corporation for a specific monthly house payment within two hours. Not only does this reassure the seller that the buyer's offer is as good as cash because he or she has been approved for a monthly payment amount, but the buyer can better determine the home price he or she can afford in advance of the home search.

Mortgage lenders aren't the only providers that have been innovative in their response to marketplace changes. Many real estate brokers have also adapted to their customers' increased demand for convenience and increased service by upgrading and expanding their products and services. To do so, they've found it necessary to invest in additional education and training for their sales associates in mortgage and other real estate services. They have also invested in telephone hotline systems or have entered into contractual relationships with mortgage lenders in order to offer mortgages through the electronic loan origination systems I just mentioned. For example, many Coldwell Banker brokers have invested in loan origination systems offered by Sears Mortgage Corporation and by other companies.

In addition, many real estate brokers are expanding their customer services by creating joint ventures, creating partnerships or affiliating with mortgage companies or other real estate service providers. These joint ventures, partnerships and affiliations are referred to under RESPA as "controlled business arrangements", although I think this term is a misnomer because real estate brokers are never controlled, nor do they want to control what their customers choose. A better term for these relationships would be "affiliated business arrangements."

Sears/Coldwell Banker is probably the most well-known of these controlled or affiliated business arrangements. But even "mom and pop" brokers across the country are finding they can better meet their customers' needs in today's marketplace by creating a partnership, joint venture or other affiliation with a mortgage lender, insurer, title or escrow provider. Not only do these relationships allow brokers to more efficiently offer a full array of products to their customers, but it also increases the service and commitment of each of the affiliated companies. For example, all Sears real estate service providers are part of the Sears Financial Network. We know that our customers perceive all of our companies as one -- in our case, Sears. So we know that each of our companies needs to provide excellent service, because if there is a problem with one of our companies it reflects poorly on the Sears name.

DOES RESPA ACCOMMODATE THESE MARKETPLACE CHANGES?

Unfortunately, the current regulatory environment stifles the further development of innovative products and services that advanced technology permits and that customers demand. This is because of (1) confusing guidance from HUD for companies that want to develop creative products and services without violating RESPA's criminal and civil sanctions; (2) conflicting interpretations of RESPA by the courts; and (3) the proliferation of protectionistic state laws at the urgings of certain mortgage bankers and others who strive to protect themselves against the increased competition from real estate brokers or other service providers.

1. Confusing Guidance from HUD

Because a reputable company does not want to inadvertently subject itself to RESPA criminal or civil sanctions, it must rely on HUD to interpret RESPA in a way that provides clear guidance on what is permitted and what is not. This guidance has not been forthcoming over the last several years. Attachment 5 to my testimony discusses this in detail, but let me offer a few specific examples:

- Regulations on the "Controlled Business Arrangement" portion of RESPA, which was enacted in 1983, have never been issued. Instead, companies like Coldwell Banker have been forced to rely on a series of HUD opinion letters through the years that often reach inconsistent conclusions about what affiliated companies can or cannot offer their customers.

- The only consistent theme that emerges from these HUD opinion letters is that RESPA prohibits wholly-owned subsidiaries of a company from engaging in activities that would be permissible if undertaken by two divisions of the same company. This interpretation elevates form over substance and has the effect of forcing a company into a structure that restricts its ability to offer its customers products and services in the least costly and most efficient manner.

- HUD's interpretation of the employer/employee exception to RESPA is also confusing. HUD has correctly observed in the past that compensation by an employer to an employee is outside the scope of RESPA. HUD's recent opinions, however, say that an employer cannot compensate an employee for referring business to another affiliate in the company.

- HUD's May 1988 proposed rule on RESPA (which was never finalized) proposed disclosure requirements that would have made it impossible to offer products and services through new distribution methods such as telephone hotlines, FAX machines and computers.

- HUD's May 1988 proposed rule also suggested that programs which offer discounts to consumers who purchase several real estate services might violate RESPA even though a consumer could still purchase each service separately and at prevailing prices. This interpretation violates one of RESPA's primary purposes: to lower the cost of settlement services.

We know that the new administration at HUD is reviewing the RESPA issue and we hope that HUD will be able to provide more consistent and logical guidance in the future. It is essential that it does so. But consistent and logical Federal regulatory guidance on what the current RESPA law allows is only a part of the solution.

2. Conflicting Guidance from the Courts

RESPA has also been interpreted in a conflicting and confusing manner by the courts. For example, in the four states under the jurisdiction of the Sixth Circuit Court of Appeals, real estate brokers may provide mortgage services without regard to RESPA because of a Sixth Circuit ruling that Congress did not intend mortgages to be "settlement services" under RESPA. A Federal District Court in Massachusetts has agreed with this conclusion. But because HUD appears to disagree with this result, real estate brokers who offer mortgages in all other states face uncertain and inconsistent rules on how mortgages can be offered.

3. Proliferation of Protectionist State Laws

In the absence of any clear guidance from HUD and the courts, many states have begun to fill the void by enacting their own laws. Unfortunately, most of these laws are being enacted in response to aggressive lobbying efforts by certain mortgage bankers and other real estate service providers who are trying to restrict their new competitors from offering products that meet consumer demands.

Consequently, these state laws often add layers of restrictions on top of the Federal law. In addition, no two state laws are the same, despite the fact that the real estate transaction and a real estate broker's basic responsibilities to his or her customers are identical in all states.

In 1989 and 1990 these state laws have proliferated faster than ever before. We expect this trend to continue until Congress and HUD develop a long-term solution to the RESPA issue.

We at Coldwell Banker strongly believe that combination of (1) confusing guidance from HUD, (2) conflicting guidance from the courts, and (3) protectionistic state laws has severely hampered the ability of mortgage lenders and real estate brokers to effectively, efficiently, and creatively respond to technology and consumer demand. If Congress and HUD do not provide more consistent guidance in the future, the end result will be less competition, less choice, and higher costs for consumers.

COLDWELL BANKER'S RECOMMENDATIONS TO CONGRESS

1. Reject Attempts to Artificially Segment the Industry

Whenever there are fundamental shifts in the marketplace, there are always those who want to stop the changes from taking place. In this case, some parts of the mortgage lending industry fear increased competition from real estate brokers and other service providers. These fears have led them to encourage Federal and state policymakers to restrict competition by placing industries in well-defined "compartments". As I mentioned earlier, these companies have already had some success at the state level.

At the Federal level, the Mortgage Bankers Association (MBA) wants Congress to amend RESPA to prohibit real estate brokers from being compensated by either a mortgage lender or a homebuyer for the fair value of his or her work in providing mortgage services. Sears/Coldwell Banker strongly opposes this proposal. As I mentioned earlier, many real estate brokers -- including Coldwell Banker brokers -- have responded to their customers' demands for convenience and increased service by investing in electronic loan origination systems, telephone hotlines, and additional education and training for their sales associates in mortgage and other real estate related services. Once they have made this investment, they may choose to accept compensation from a mortgage lender for the fair value of loan processing services — services for which the lender otherwise would have to pay a loan officer. Real estate brokers may also provide mortgage consultation services which homebuyers often choose to pay for if they find the services valuable. Congress should not discourage real estate brokers from providing these mortgage services by restricting their ability to be compensated by the mortgage lender or homebuyer for their fair and reasonable value.

Unfortunately, some of those who advocate legislative restrictions have been trying to create unjustified fears about potential consumer abuses from these practices. Attachment 6 to my testimony points out the fundamental flaws of these arguments. I would like to emphasize, however, three important points:

- The issue is not "referral fees" or "kickbacks", which are illegal under RESPA. The issue is whether real estate brokers should be compensated for the value of legitimate services they provide to the customer.

- There are potential safeguards to protect the consumer from unscrupulous tactics and hidden costs without preventing the consumer from taking advantage of the increased convenience and choice that results from purchasing more than one service from a single provider, such as:

    -- Full disclosure by the real estate broker of relationships with any other parties to the transaction. One example of a disclosure currently required under RESPA is the "controlled business" disclosure for affiliated companies like Coldwell Banker, which discloses the affiliation and the normal charges for each service offered.

    -- Reasonable anti-tying requirements which prevent a provider from conditioning the supply of one product with the purchase of another without prohibiting legitimate discounts on the purchase of multiple services that offer cost savings to the customer.

- Finally, any attempt to legislate real estate brokers out of the mortgage delivery system should be recognized for what it is -- a glaring attempt to restrict new competition at the expense of the consumer.

If Congress prevents real estate brokers from being compensated for the fair value of their work in providing mortgage services to consumers, other real estate service providers will seek even more restrictions from Congress in the future to protect their industries as well. In the long term, these artificial restrictions on the flow of information and the distribution of products and services in the marketplace will substantially hurt the consumer by lessening competition and consumer choice and by unnecessarily increasing consumer costs.

2. Need for Comprehensive RESPA Study and Reform

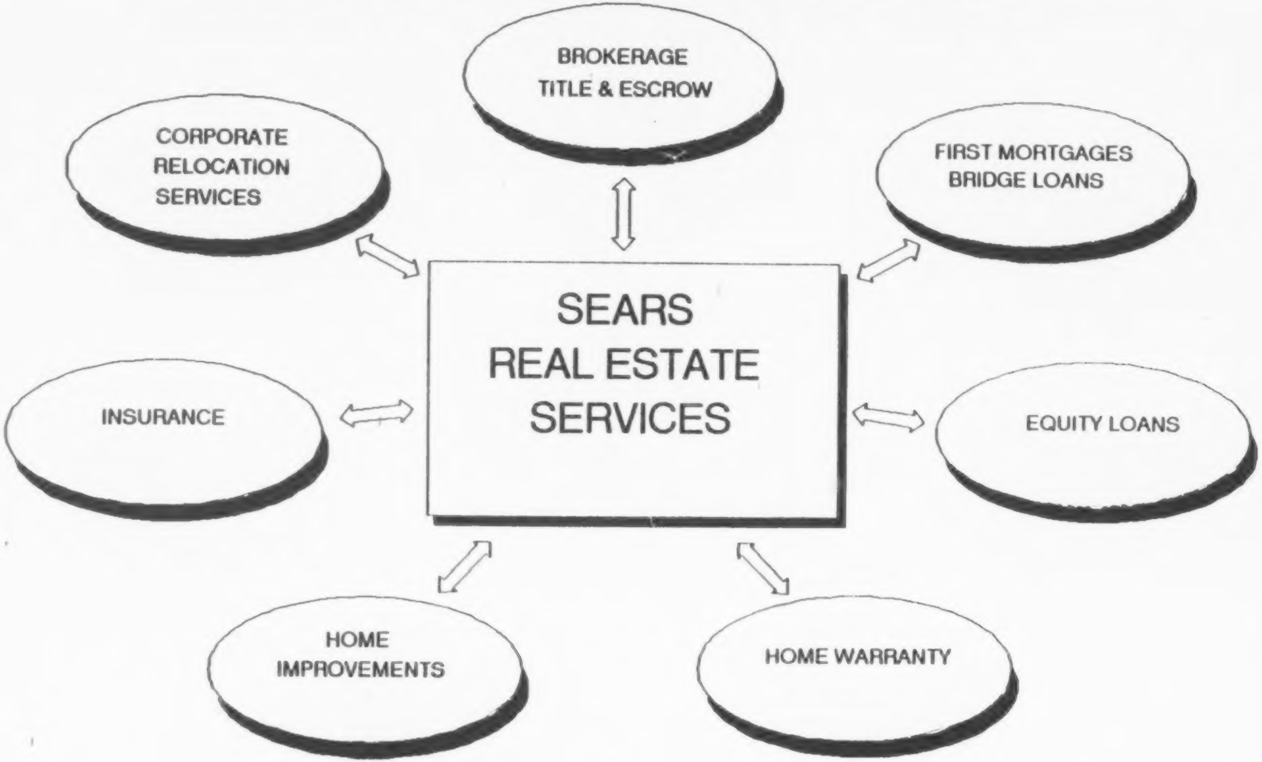
Instead of considering legislative changes to RESPA on a piecemeal basis, we at Coldwell Banker believe that the time has come for Congress and the Administration to begin a comprehensive review of the effect of the current regulatory environment on today's real estate marketplace, with the goal of creating a modernized Federal regulatory structure that fulfills RESPA's original purposes of providing consumers with more information and lower costs without protecting certain competitors over others. This regulatory structure should encompass two principles:

> 1. A real estate broker, mortgage lender or any real estate service provider should be able to offer his or her customers a full array of products in the most cost-efficient manner possible -- whether it be through contractual arrangements, joint ventures, partnerships or affiliations with other providers.
>
> 2. Real estate brokers who offer related services should protect consumers against potential abuses by (1) disclosing the nature of any relationship with other parties to the transaction; (2) disclosing any fees charged and the services which were provided for these fees; and (3) giving their customers the choice of purchasing the related services from another provider.

We hope that these hearings will encourage the Committee to begin this comprehensive review. We at Coldwell Banker look forward to working with you and the Committee, Mr. Chairman, on this critical issue.

ATTACHMENT 1

SEARS OFFERS A WIDE ARRAY OF REAL ESTATE RELATED SERVICES TO THE HOME BUYER AND SELLER



SEARS
REAL ESTATE
SERVICES

BROKERAGE
TITLE & ESCROW

FIRST MORTGAGES
BRIDGE LOANS

EQUITY LOANS

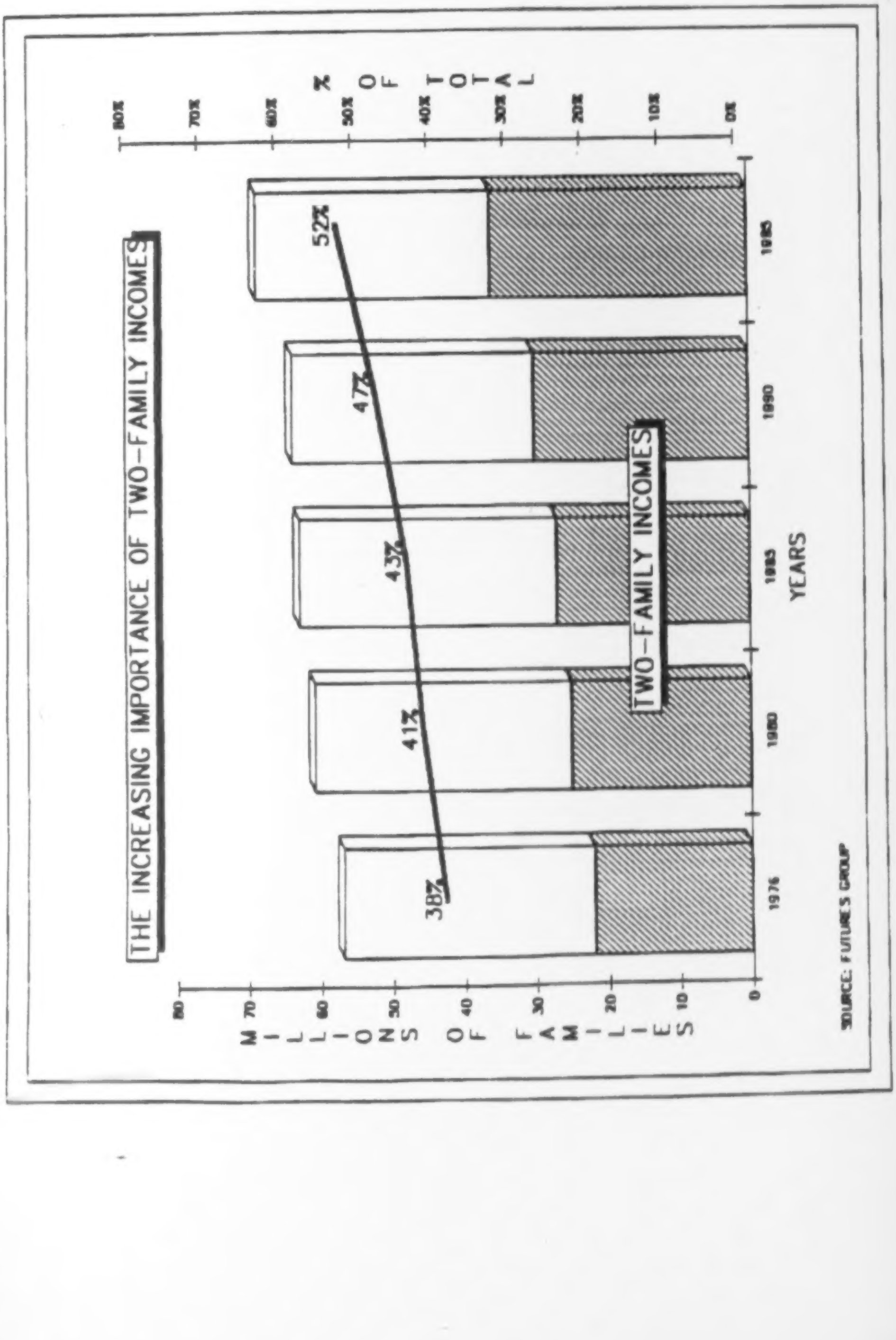
HOME WARRANTY

HOME
IMPROVEMENTS

INSURANCE

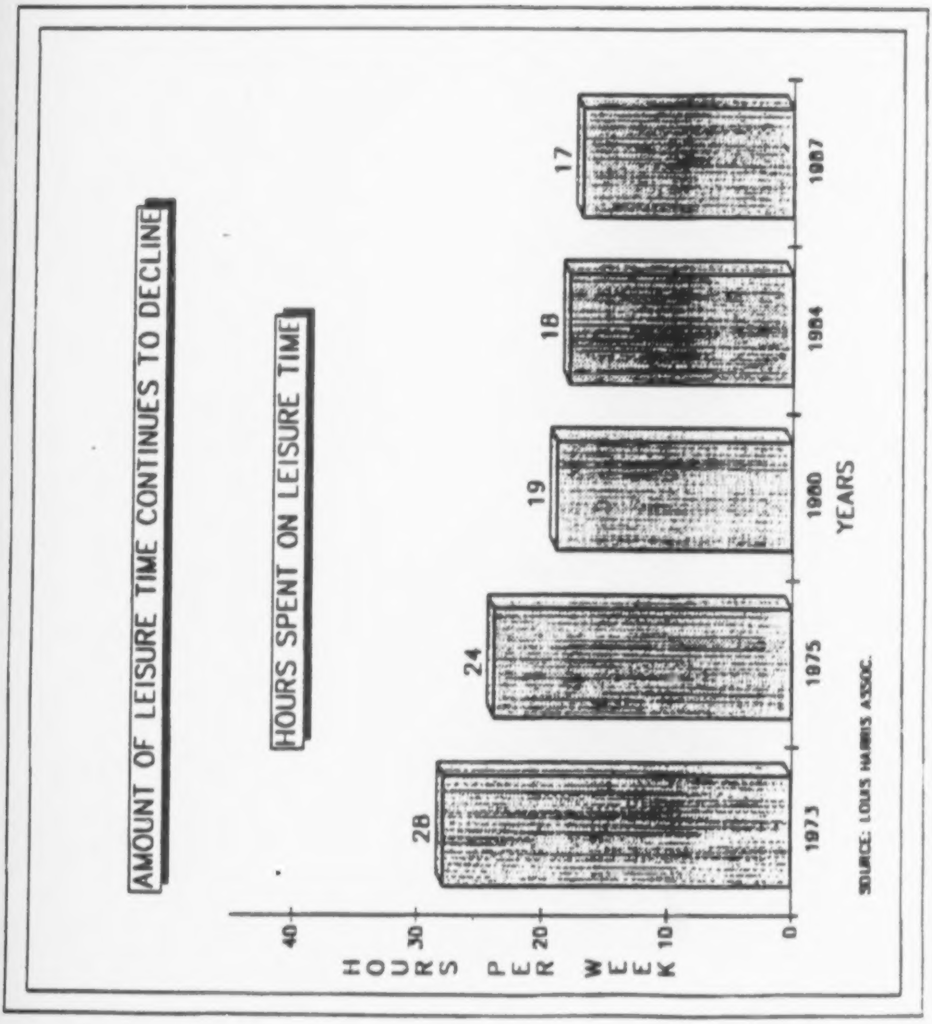
CORPORATE
RELOCATION
SERVICES

ATTACHMENT 2



SOURCE: FUTURES GROUP

ATTACHMENT 3



ATTACHMENT 4

COMMISSION AUTHORIZED

UNITED STATES OF AMERICA
DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

Proposals to Relax the Interpretation
of Section 8 with Regard to Home
Mortgages

Docket No. R-88-1256

July 15, 1988

STATEMENT OF THE STAFF OF THE BUREAU OF ECONOMICS OF THE UNITED STATES FEDERAL TRADE COMMISSION

I. Introduction and Summary

Section 8 of the Real Estate Settlement Procedures Act of 1974 (RESPA)[1] prohibits compensated referrals for "business incident to or part of a real estate settlement service involving a federally related mortgage loan." Violations of Section 8 are subject to criminal and civil penalties. In a Notice of Proposed Rulemaking (NPRM),[2] the Department of Housing and Urban Development (HUD) announced that it is considering whether to create exemptions to the application of Section 8. This analysis by the staff of the Federal Trade Commission[3] suggests that these, and other exemptions, may provide significant benefits to consumers.[4]

HUD is proposing to exempt from Section 8 payments by a borrower (but not a lender) to mortgage brokers or other intermediaries, such as real estate agents, who assist in bringing the borrower and lender together.[5] HUD is also considering whether to exempt payments by a lender to a mortgage broker or any other person who assists in bringing the borrower and lender together, as long as that person does not provide any other settlement service in connection with the transaction and does not receive any other compensation from the borrower, seller, or any other person for services related to the transaction ("neutral intermediaries").[6]

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[1] Real Estate Settlement Procedures Act of 1974, Pub. L. 93-533 (1974) (codified at 12 U.S.C. Section 2601 et seq.).

[2] 53 Federal Register 17424 (1988).

[3] These comments are the views of the staff of the Bureau of Economics of the Federal Trade Commission. They are not necessarily the views of the Commission or of any individual Commissioner. Please contact staff economist Carolyn A. Woj at (202) 326-3434 should you have any questions regarding our comments.

[4] NPRM at 17428. Legal issues pertaining to the inclusion of mortgage loans in the definition of settlement services will not be addressed in this comment.

[5] NPRM at 17429; 24 C.F.R. § 3500.14 (g)(6). If adopted, the proposed regulation would formalize a legal opinion issued by HUD's former General Counsel. This opinion approved a mortgage brokering program involving voluntary payments by borrowers to persons who assisted in bringing the lender and borrower together. NPRM at 17429.

The first proposal would formally authorize payments by borrowers to persons who search for loans on their behalf, a practice that is now allowed under an informal legal opinion by HUD's former General Counsel. We believe that this practice may increase consumer welfare relative to an environment where no such payments are permitted. Allowing borrowers to hire agents or brokers to locate loans will, of course, create some risk that the agent will not diligently search for the best loan available. Because the borrower may not have sufficient information to assess the performance of the agent, the agent may not seek the loan with the lowest interest rate, instead settling for the first loan for which a buyer is qualified. Nevertheless, the mere possibility of this harm does not necessarily warrant prohibiting transactions between borrowers and mortgage brokers, for these transactions may create substantial benefits by lowering consumers' search costs. Moreover, since only the consumer pays for the services, there is no risk that the consumer will be steered to only those lenders who pay referral fees.

HUD is also considering whether to allow payments by lenders to persons who bring borrowers and lender together, although only under a restrictive set of conditions. The person cannot provide any other settlement services and cannot receive any other compensation from the seller or buyer. Even under these restrictive conditions, however, permitting the payment of fees by lenders to intermediaries could further increase the available volume of truthful information about home mortgages, which would benefit consumers. Other possible benefits include more rapid development of innovative forms of service, such as computerized loan origination services, and increased competition in the market for home mortgages. In addition, we suggest that HUD consider expanding this option to allow payment of referral fees to any persons, regardless of whether they meet the restrictions. Such fees could encourage real estate brokers and others to provide even more options to borrowers, and to adopt cost saving innovations more rapidly.

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[6] NPRM at 17429. This exemption would not extend to the payment of referral fees by lenders to real estate brokers, since these persons do provide other settlement services related to the transaction.

Although permitting the payment of fees from lenders to all types of intermediaries may generate consumer benefits, it also creates the possibility of consumer losses. Under certain circumstances, this option may result in non-neutral, or "interested" intermediaries steering consumers to loans whose provisions are less favorable than those offered by a lender who does not pay a fee. These possible costs must be weighed against the possible benefits from lender payments. Though we lack sufficient data to quantify precisely these costs and benefits, our analysis suggests that any possible concerns associated with the payment of referral fees can be adequately addressed through some form of mandatory disclosure, whereby interested intermediaries would be obligated to notify their clients of the existence of referral fee arrangements with lenders.

The remainder of this submission is organized as follows. Section II describes the interest and relevant experience of the Federal Trade Commission staff. Section III reviews the rationale underlying enactment of

Section 8. Section IV examines the likely incentive effects of referral fees and the reasons why their prohibition may sometimes be desirable. Section V discusses the market for home mortgages and provides an analysis of the proposals, including an examination of their potential costs and benefits. In addition, we provide a framework within which to consider the costs and benefits of a mandatory disclosure that a referral fee will be paid. Section VI presents our conclusions.

II. Interest and Experience of the FTC

Under the Federal Trade Commission Act, 15 U.S.C. § 41 et seq., the Commission is charged with preventing unfair methods of competition and unfair or deceptive acts or practices. The staff of the Federal Trade Commission, upon request by federal, state, and local governmental bodies, regularly analyzes regulatory proposals to identify provisions that may impede competition or increase costs without providing countervailing benefits to consumers.

For several years, the Commission staff has examined the competitive effects of various restrictions on state-licensed professionals, including optometrists, dentists, and lawyers.[7] Among the restrictions that we have examined are ones that, like Section 8, prohibit the payment of referral fees.[8] In addition, the Commission staff has extensively studied the nature of competition in the real estate industry.[9]

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[7] See Liang and Ogur, Restrictions on Dental Auxiliaries (Federal Trade Commission, 1987); Improving Consumer Access to Legal Services: The Case for Removing Restrictions on Truthful Advertising (Federal Trade Commission, 1984); Bond, Kwoka, Phelan, and Whitten, Effects of Restrictions on Advertising and Commercial Practice in the Professions: The Case of Optometry, (Federal Trade Commission, 1980).

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[8] Comments of the Federal-Trade Commission's Bureaus of Competition, Consumer Protection and Economics re the Development of Regulations Pursuant to the Medicare and Medicaid Anti-Kickback Statute, Presented to the Department of Health and Human Services (December 18, 1987); Letter from Janet M. Grady, Regional Director, San Francisco Regional Office, Federal Trade Commission to Hon. Chuck Hardwick, Speaker of the Assembly of the State of New Jersey, re Assembly Bill 2647, which would have prevented a physician from referring patients for physical therapy to an entity in which the physician's family had any financial interest (May 21, 1987); Letter from Walter T. Winslow, Acting Director, Bureau of Competition, Federal Trade Commission to H. Fred Varn, Executive Director, Florida Board of Dentistry (Nov. 6, 1985); Letter from Walter T. Winslow, Acting Director, Bureau of Competition, Federal Trade Commission to George M. Sanchez, O.D., President, Arizona State Board of Optometry (Oct. 17, 1985). Copies of these comments are available from the Federal Trade Commission's Office of Public Reference.

[9] *The Residential Real Estate Brokerage Industry* (Los Angeles Regional Office (LARO) of the Federal Trade Commission, 1983); Butters, *Consumers' Experiences with Real Estate Brokers: A Report on the Consumer Survey of the Federal Trade Commission's Residential Real Estate Brokerage Investigation* (Federal Trade Commission, 1983). Our law enforcement initiatives have also developed expertise within the staff. Florence Multiple Listing Service Inc. of Florence, S.C., No. C-3228 (April 20, 1988) (consent order settling charges that respondent had restrained competition by restricting membership); Multiple Listing Service Mid County Inc. of Brooklyn, N.Y., No. C-3227 (April 20, 1988) (consent order ending practices that allegedly restrained price and service competition among residential real estate brokers); *Multiple Listing Service of Greater Michigan City Area, Inc.*, 106 F.T.C. 95 (1985) (consent order); *Orange County Board of Realtors, Inc.*, 106 F.T.C. 88 (1985) (consent order); Brief for the Federal Trade Commission as *Amicus Curiae Coldwell Banker Residential Real Estate Services of Illinois, Inc. v. Clayton*, 105 Ill. 2d 289, 475 N.E. 2d 536 (1985).

III. Stated Purpose of the RESPA Section 8 Provision

In the late 1960's, concerns arose that the cost of real estate settlement services could be so substantial as to interfere with the national goal of widespread home ownership.[10] In 1969, concerns over what were considered to be unnecessary and inflated settlement costs led a Congressional subcommittee to hold public hearings.[11] In response to the hearings and subsequent report (which expressed concern over the cost of settlement services), Congress enacted section 701 of the Emergency Home Finance Act of 1970.[12] This provision directed HUD and the Veterans Administration (VA) to study real estate settlement costs.[13]

One of the primary factors[14] identified in the HUD/VA Report[15] as contributing to the allegedly high price of settlement services was a system of rebates and referral fees then existing in the industry.[16] Given its authority under Section 701 of the Emergency Home Finance Act of 1970, HUD established proposed maximum fees for certain settlement costs in 1972. Because of Congressional opposition to, and criticism of, the maximum fee schedules, the schedules were not published in final form.[17] RESPA, however, was enacted in 1974, and contained a provision that prohibited the payment or receipt of referral fees for business incident to settlement services involving a federally related mortgage loan.[18] It was thought that a prohibition of referral fees would decrease the cost of providing settlement services and benefit consumers by lowering prices.

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[10] Whitman, Home Transfer Costs: An Economic and Legal Analysis, 62 Georgetown Law Journal 1311 (1974).

[11] The hearings were held on conditions then existing in Washington, D.C.

[12] Barron, Federal Regulation of Real Estate: The Real Estate Settlement Procedures Act 11 (1975).

[13] Emergency Home Finance Act of 1970, § 701. USCA 12 § 1710. This provision also directed HUD and the Veterans' Administration (VA) to provide Congress with appropriate recommendations, and to set standards governing settlement costs in connection with Federal Housing Administration (FHA) and VA home loans.

[14] Other factors cited in the report include excessive specialization and excessive duplication in the land title record system.

[15] Senate Committee on Banking, Housing and Urban Affairs, 92d Congress, 2d Session, Mortgage Settlement Costs: Report of Department of Housing and Urban Development and Veterans' Administration (1972).

[16] The report concluded that "[c]ompetitive forces in the conveyancing industry manifest themselves in an elaborate system of referral fees, kickbacks, rebates, commissions and the like as inducements to those firms

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and individuals who direct the placement of business. These practices are widely employed, rarely inure to the benefit of the home buyers, and generally increase total settlement costs." HUD/VA Report at 3.

All of the study's participants did not concur in the study's findings. John C. Payne of the University of Alabama Law School acted as a consultant to the study. He observed that "[t]he basic data collected relates only to FHA and VA insured mortgages, no effort has been made to classify rationally the information obtained, and all elements of transactions other than monetary outlay have been ignored. It is impossible to begin a consideration of the legitimacy of costs until we know exactly who performs what services, for whom, under what conditions, and at what cost." Hearings before the Subcommittee on Housing and Urban Affairs of the Committee on Banking, Housing and Urban Affairs, United States Senate 92d Congress Second Session on Mortgage Settlement Costs March 1, 2, and 3, 1972, p. 219.

[17] Barron, Federal Regulation of Real Estate: The Real Estate Settlement Procedures Act 18 (1975).

[18] Federally related mortgage loans include any loan that is "made in whole or in part by any lender the deposits or accounts of which are insured by any agency of the Federal Government, or is made in whole or in part by any lender which is regulated by any agency of the Federal Government." RESPA Section 3500.2 (b) (2) (i). Most home mortgage loans are covered by RESPA.

IV. The Use of Referral Fees Between Intermediaries and Providers

Referral fees provide intermediaries with an incentive to recommend the use of a particular professional or firm to consumers. In essence, they are, like advertising, a means for a business to attract customers. In a world of perfect information and perfect competition, advertising, referral fees, and recommendations would not be needed.[19] Since any consumer could evaluate the available combinations of price and quality offered costlessly, advertising or a recommendation from a third party would be of no additional value. Firms would appeal to consumers directly, rather than by advertising or by paying third parties to recommend them. Firms could attract customers by simply lowering prices and/or increasing quality.

Advertising and referral fees are used when information is costly to obtain. Both theoretical[20] and empirical studies[21] indicate that by increasing the amount of information on price and quality available to consumers, advertising actually decreases prices. Similarly, commissions or referral fees, by increasing the amount of information available, may increase competition and decrease prices.

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[19] See Pauly, The Ethics and Economics of Fee-Splitting, 10 Bell Journal of Economics 344 (1979).

[20] See Stigler, The Economics of Information, 69 Journal of Political Economy 213 (1961).

[21] Improving Consumer Access to Legal Services: The Case for Removing Restrictions on Truthful Advertising (Federal Trade Commission, 1984); Effects of Restrictions on Advertising and Commercial Practice in the Professions: The Case of Optometry (Federal Trade Commission, 1980); Benham and Benham, Regulating Through the Professions: A Perspective on Information Control, 18 Journal of Law and Economics 421 (1975); Benham, The Effects of Advertising on the Price of Eyeglasses, 15 Journal of Law and Economics 337 (1972).

Through advertising, firms attempt to convey information on price and quality to consumers directly. In many real-world situations, they may also find it advantageous to provide other parties with an incentive to market their products for them. Such agreements between producers and marketers are a form of a "vertical" relationship. The term "vertical" refers to a relationship that involves some financial agreement between a producer and an intermediary (e.g., a dealer, distributor, or broker). A vertical relationship might take the form of a sales commission paid to a dealer, i.e., the dealer receives a percentage of the sales price when the good is sold. This percentage can be adjusted by the producer to increase or decrease the dealer's incentive to market the product. Alternatively, a vertical relationship might take the form of a referral fee, whereby the producer pays a referral fee to the dealer (or, more likely, the "broker") for promoting the producer's goods or services. The difference between a "commission" and a "referral fee" is thus more semantic than economic. As the following examples show, both commissions and referral fees are found in a multitude of settings, and both often provide benefits to producers and the ultimate consumers.

A good example of an efficient vertical relationship can be found in the markets for fire, auto, and homeowners insurance. Many insurers sell their policies through independent agents and brokers, while others employ their own sales force. An independent agent typically sells policies for numerous insurance companies. Consumers can choose between contacting the representatives of different direct writers, each of whom will try to sell a policy of its parent company, or they can contact an independent agent, who will search and evaluate the offerings of a number of different companies.

Many consumers apparently prefer to use independent agents. These agents know about different insurers, so they can search at a lower cost than can a person who is searching for the first time. By providing consumers access to information regarding numerous insurers at one location, independent agents substantially reduce consumers' search costs.

Independent insurance agents are compensated by commissions and bonuses when they sell the policy of a particular company. These commissions are the equivalent of "referral fees," and they can serve a competitive purpose.[22] Independent agents can provide insurers access to markets that they might not have entered because of the high costs of opening individual insurers' offices in those markets. By making entry less costly, independent agents increase competition among insurers.

As an alternative to the payment of referral fees or commissions, a firm that is attempting to attract customers could merge, or vertically integrate, with the referring party. In doing so, the firm could assure itself that its own representatives will refer customers to it. Like referral fees, these sorts of arrangements are widespread and, like referral fees, can provide competitive benefits. In the real estate market, for example, some firms offer "in house" financing with the home purchase.[23] Rather than referring customers to outside lenders, the firm "refers" customers to its own financing division. Consumers are offered the choice of obtaining the home and the mortgage from a single source, or obtaining the home from one firm and the mortgage from another. This practice presents consumers with a "one-stop" shopping option that they may often find convenient.

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[22] Another market in which the use of commissions, or referral fees, serves to increase competition is the market for job placement services. The employer typically pays the placement firm a referral fee when the placement firm locates a suitable employee. This arrangement, by reducing the search costs of both job hunters and employers, benefits consumers.

[23] Firms that offer financing with the home purchase include Coldwell Banker, Ryan Homes, Haddon Group, Winchester Homes, Pulte, U.S. Home, Christopher, and Richmar. According to Chuck Reeker of Ryan Homes, it is relatively common for builders to offer financing.

If referral fees are permitted, independent agents and lenders are encouraged to set up a close working relationship, realizing many of the same benefits as vertically integrated firms.[24] However, a prohibition on referral fees can prevent independent firms from realizing these benefits and place non-integrated firms at a competitive disadvantage. For example, a financial institution could vertically integrate with a real estate broker and thereby assure itself of a flow of referrals without explicitly paying referral fees. Such vertical relationships can circumvent any prohibition on referral fees. Although vertical integration may benefit consumers, it may do so at a higher cost than if the firms were able to attract business through the use of referral fees.

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[24] The "preferred provider organization" found in the health care industry represents another procompetitive referral fee system. Although they exist in many forms, all PPO programs involve an arrangement between "preferred" health care providers (e.g., a set of hospitals) and an intermediary, such as an insurer or self-insured employer. The preferred provider typically charges the PPO a price below what it charges other insurers to induce the PPO to encourage its subscribers to use the provider. This is the economic equivalent of a referral fee. In turn, enrollees in PPOs usually are given financial incentives (e.g., waivers of copayments and deductibles) to induce them to use the lower-priced providers.

These PPO arrangements have many procompetitive aspects and are widely credited with introducing elements of price competition into hospital markets where little was formerly present. See Dranove, et al. The Effect of Injecting Price Competition into the Hospital Market: The Case of Preferred Provider Organizations, 23 Inquiry 419 (1986).

In addition, other areas of retail distribution offer examples of the joint provision of sales services and financing services that are equivalent to firms using unrelated intermediaries who bring the firm and the consumer together. Retail dealers of consumer products such as autos, home appliances, and furniture commonly offer financing as an additional service, as do department stores. Many, if not most, auto dealers offer a financing option along with their primary product, automobiles. Consumers are typically offered the choice of purchasing a car and the loan from one dealer, or obtaining the loan from a different source. Appliance and furniture dealers frequently offer their customers similar opportunities for obtaining credit. These arrangements do not appear to differ in any meaningful respect from a system of referral fee payments, yet quite clearly can benefit consumers by reducing search and transaction costs.

Referral fee arrangements between unrelated entities and transfer payments within an integrated company are distinguishable in that the existence of a financial relationship between the affiliated components of the integrated company is self-evident, whereas when a lender pays a referral fee to an unrelated agent the relationship need not be publicly known. To the extent that consumer awareness of this relationship may be important (e.g., when interested persons are allowed to pay or receive referral fees), some sort of mandatory disclosure of the arrangement may be merited. In section V.C. below, we discuss the costs and benefits of a mandatory disclosure requirement.

Consumers may not always benefit from referral fees (or the integration of the referring party and the service provider). For some goods or services, it may be difficult for consumers to determine the benefits that are generated by the good or service, even after it has been consumed. In the most extreme case, consumers may be completely unable to evaluate the contribution of the purchased good to the satisfaction of their demands. In such instances, the existence of financial arrangements between intermediaries and service providers can create an opportunity for defrauding consumers. Essentially, the intermediary and the provider can increase their incomes by inducing a customer to purchase a greater quantity of the good, and/or pay a higher price for the good, than the customer would if he or she were perfectly informed.[25]

A similar phenomenon might occur in the provision of auto repair services.[26] A person might wish to buy services from a mechanic in order to produce a "reliably operating car." The mechanic (who jointly provides both a diagnosis and a set of "recommended" repair services) could exploit this person's ignorance of automobiles by providing a misleading diagnosis requiring significant repairs, and then by installing unneeded replacement parts. The customer cannot tell if he was defrauded, since the car runs well after the unnecessary repairs are conducted; hence, he cannot deter such behavior by threatening to withhold future business. This sort of fraudulent behavior can persist even when there is a competitive market for repair services.

The opportunities for this sort of fraud increase as the consumer's cost of evaluating a product or service increase. A customer can secure protection from this sort of fraud by using an intermediary that is financially unrelated to the provider[27] (or by acquiring the requisite expertise himself), but the costs of doing so may be quite high. Even under these circumstances, however, it may be difficult to justify the banning of arrangements between intermediaries and providers, since there may be substantial savings associated with referral fees or with purchasing the recommendation and the service from the same source. These savings may offset the expected costs of fraud.[28]

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[25] See Darby and Karni, Free Competition and the Optimal Amount of Fraud, 16 Journal of Law and Economics 67 (1973).

[26] Another example may be found in the market for physicians' services. Physicians typically diagnose a malady, and then prescribe and supply a course of therapy. Consumer ignorance makes it possible for physicians to prescribe unneeded treatments. This behavior can be constrained (e.g., by soliciting second opinions), but only at a cost.

[27] To provide the intermediary that does not receive referral fees with the incentive to produce an honest diagnosis, the customer can make it clear to the intermediary that another party will provide whatever service is recommended; otherwise, incentives for fraudulent diagnoses will remain.

Whether a ban on the payment of referral fees in the context of home mortgages is, on balance, efficient will be determined by (1) the cost to borrowers of evaluating the "quality" of the services referred (i.e., assessing the terms offered by the referred lender relative to alternatives), and (2) the benefits in terms of efficiencies generated by these arrangements between intermediaries and lenders. If the cost to borrowers of evaluating the quality of the referral is sufficiently low, and the benefits of referrals are sufficiently high, imposing restrictions on the creation of these arrangements may produce a net harm for consumers. Therefore, we would like to offer some observations that may be useful in HUD's evaluation of this issue.

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[28] Using the car repair example, Darby and Karni (Free Competition and the Optimal Amount of Fraud, 16 Journal of Law and Economics 70 n. 6 (1973)) cite the situation where it is necessary to disassemble an engine to diagnose a problem. It may be much cheaper to incur the risk of fraud, and have the repair made when the engine is taken apart, than to reassemble it for repair elsewhere.

Other good examples can be found in the market for medical services. Because physicians typically provide both diagnosis and therapy, the opportunity for fraud (e.g., "unnecessary surgery") exists. For expensive procedures (e.g., coronary bypass), it may pay to seek advice from another physician. For many procedures, however, the costs of soliciting a second opinion will outweigh the expected benefits, and the patient (or his insurer) will find that the best alternative is to purchase both diagnosis and therapy from the same source.

V. Possible Efficiencies From the Use of Brokers

A. Proposal One - Allowing Borrowers to Hire Brokers

Consumers do not have perfect information in the market for financial services. Information on mortgage loan rates, although available, is not free. The time and effort expended searching for the best loan represents a cost to the consumer. Because search involves costs, consumers search until the expected benefits of additional search are equal to the expected costs of additional search.[29] Consumers appear to engage in relatively little detailed comparison shopping for credit. A 1977 Consumer Credit Survey found that only approximately one-quarter of the respondents tried to obtain additional information about other creditors or credit terms prior to engaging in a recent credit transaction.[30] In addition, a 1978 home buyer survey conducted in Rochester, New York revealed that "[m]ost of the people who have a mortgage from a lending institution contacted but one institution to secure it, 84.4 percent in the central city and 89.9 percent in the suburb."[31]

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[29] See Stigler, The Economics of Information, 69 Journal of Political Economy 213 (1961).

[30] Durkin and Elliehausen, 1977 Consumer Credit Survey, 22 (Board of Governors of the Federal Reserve System, 1978). Responses were elicited from persons using credit of at least $200 from institutional sources. This study did not examine consumer search for home mortgages as a separate category. Mortgages were, however, one of the items included in the broad definition of credit.

[31] Benston, Horsky and Weingartner, "The Demand for Real Estate Loans in Rochester --- Central City vs. Suburb" in An Empirical Study of Mortgage Redlining (New York University Graduate School of Business Administration's Monograph Series in Finance and Economics, Monograph 1978-5).

Gains from search, however, do appear to exist. In early 1986, a 30-year fixed rate mortgage in New York City, for example, ranged from 11.5 percent with 3 origination points, to 9.88 percent with 2.5 origination points.[32] Other studies have found that "no single lender - not even the very largest - had the best loan offering on any single day more than 30 percent of the time."[33]

Since search involves some costs, but benefits from search exist, consumers may prefer to designate an agent to undertake this task for them. A large number of consumers rely on their real estate agent. A FTC staff report[34] on the residential real estate brokerage industry revealed that 67 percent of home buyers surveyed thought that the real estate agent's ability to help obtain financing was an important service characteristic.[35] About half (50.8 percent) of those surveyed said that their agent provided this service.[36]

Real estate agents are not the only persons on whom consumers can rely to obtain information on mortgage loans. Mortgage brokers, for a fee,[37] search for the best loan for a particular consumer. The ability of these intermediaries, including real estate agents, to provide consumers with information on the loan terms of a variety of lenders may substantially benefit consumers.[38] HUD's proposal to allow voluntary payments by a consumer to persons who perform these brokerage services therefore could benefit consumers. The proposal would permit consumers the options of undertaking the search process themselves, paying an agent to research loan availability and make a recommendation, or doing both.

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[32] Securitising the American Dream, 299 Economist 70 (1986).

[33] Anderman, Take the Byte Out of Computerized Loan Origination, 18 Real Estate Today 39 (1985).

[34] The Residential Real Estate Brokerage Industry (Los Angeles Regional Office of the Federal Trade Commission, 1983).

[35] The Residential Real Estate Brokerage Industry, Buyer Survey, p. 15.

[36] Id. at 17.

[37] Mortgage brokers can simply refer consumers to a particular lender or refer consumers and handle the paperwork associated with the loan application process. If the broker simply refers a lender and the consumer chooses to use that lender, the consumer typically pays $100. If the broker performs the loan application process, a fee approximately equal to 1.5

This proposal would not only permit consumers to choose between searching for loans themselves or hiring someone else to do so, but also encourage the diffusion of more efficient technologies. For example, there have been dramatic changes in the technology with which agents undertake the search process. The use of computerized loan origination networks, first started in 1982, is significantly affecting the competitive nature of the industry. These networks assume a variety of forms, but the basic feature of the typical system is that it provides information on the loan terms offered by a variety of lenders.[39] The principal benefit of this system is

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percent of the loan value is paid if the borrower uses that lender. Telephone conversation with Mr. Hogendike, National Association of Mortgage Brokers, June, 1988.

[38] It is estimated that there are approximately 7,500 to 10,000 operating mortgage brokers today in the United States. Telephone conversation with Mr. Hogendike, National Association of Mortgage Brokers, June, 1988.

[39] Another important feature of some of these networks is that the loan application process can be performed by the individual using the system. Absent computer networks, the loan application process was typically performed by the lender at a site that was physically close to the property and the borrower. This arrangement tended to keep markets local. With the computerized systems, however, an individual located in Baltimore, for example, could apply for a loan offered by a lender in California. Guttentag, Recent Changes in the Primary Home Mortgage Market, 3(3) Housing Finance Review 244 (1984).

that it permits lenders to reach markets that otherwise would have been too costly to enter.[40] For example, when one real estate broker in the Philadelphia area joined the "Shelternet" system,[41] a number of lenders outside the Philadelphia area gained access to that geographic market.[42] By facilitating entry and improving information, the computerized networks increased consumer choice, and may have enhanced the competitive nature of credit markets.[43] Since real estate agents or mortgage brokers using the system can provide consumers with access to information on loan rates nationwide, these systems increase the likelihood that consumers will obtain a desirable loan package.[44]

Although computerized loan services are capable of providing substantial benefits to consumers, their use among real estate agents is not yet widespread. Typically, agents are charged a monthly fee for access to the loan information service,[45] but if they cannot be compensated for providing this service to customers, they have a reduced incentive to offer it. Thus, this proposal, which would make clear that compensation may be paid, should preserve the incentive for agents to adopt this technology. Allowing agents to sell this service at a market-determined price may create benefits for both buyer and seller.

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[40] See Kane, *Change and Progress in Contemporary Mortgage Markets*, 3(3) Housing Finance Review 257 (1984); Guttentag, *Recent Changes in the Primary Home Mortgage Market*, 3(3) Housing Finance Review 221 (1984).

[41] The Shelternet system, founded in 1982, provides up-to-date information on the rates of a number of lenders. As of 1986, the system linked 100 real estate offices and 20 lenders. The borrower is automatically offered a rate which is the best among the packages offered by participating lenders. *Securitising the American Dream*, 299 Economist 71 (1986).

[42] Guttentag, *Recent Changes in the Primary Home Mortgage Market*, 3(3) Housing Finance Review 245 (1984).

[43] Citicorp's computerized network, for example, has enabled it to compete vigorously with local lenders in New Jersey. By offering discounts on loan origination fees and providing other service amenities (e.g., a 10-15 day guaranteed loan commitment), Citicorp has expanded its share of the market. "Citicorp Arouses Mortgage Bankers' Ire," *Barrons*, June 27, 1988, at 81.

[44] Perhaps not surprisingly, some local lenders, who were otherwise more insulated from competition, are opposed to the use of such arrangements. Others, however, welcome the changes taking place. Len Druger, Vice-Chairman of Citicorp, states, "[t]he issue here is fair competition - competition that's ultimately good for the consumer because it cuts prices." "Citicorp Arouses Mortgage Bankers' Ire," *Barrons*, June 27, 1988, at 81.

Allowing borrowers to hire intermediaries is not completely riskless. The borrower cannot perfectly monitor the broker's efforts, so there is the possibility that the intermediary will take advantage of the lack of information on the part of the consumer. Whether this would occur with sufficient frequency and magnitude to outweigh the likely benefits of the use of intermediaries is unknown. However, both market forces (e.g. the development of poor reputations and the attendant loss of business)[46] and state and federal law enforcement presence[47] are likely to place constraints on such behavior. Furthermore, the incentive to provide misleading information or to "shirk" one's duty would be no greater than it currently is, and probably less due to competitive forces. If so, the potential net benefits from adopting HUD's proposal to permit borrowers to hire intermediaries could be substantial.

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[45] Anderman, Take the Byte Out of Computerized Loan Origination, 18 Real Estate Today 38 (1985).

[46] Substandard brokers will actually develop bad reputations only if borrowers discover at some point that they have been ill-served. Whether borrowers are likely to determine this is a point that we discuss in greater detail below.

[47] For example, the FTC issued a complaint against Donald A. Schwab and Associates Mortgage Co., a mortgage broker, for allegedly misrepresenting the availability of credit at low interest rates. The Commission approved a consent decree with the respondent on July 18, 1986. In the U.S. District Court for the Southern District of Ohio an action was brought for injunctive and other relief; a final order was accepted on September 19, 1986 (C-1-86-967).

B. Permitting Lenders to Pay Referral Fees

HUD has also requested comment on whether to add an exemption to Section 8 that would allow referral payments by a lender to "neutral intermediaries." Economic analysis suggests that HUD should consider expanding this proposal to allow lenders to pay referral fees to any persons who bring together the borrower and the lender, rather than limit referral fees to neutral intermediaries. We discuss below the potential benefits and costs of referral fees in this context.

1. Potential Benefits From the Payment of Referral Fees

Permitting lenders to pay referral fees to intermediaries may benefit consumers in a number of ways. First, referral fees may be an efficient means of conveying information to customers. They may represent an attractive substitute for, or complement to, other forms of information dissemination, such as mass media advertising. In a competitive market, innovations in the methods of transmitting information benefit both customers and producers. The FTC and others have found that innovative advertising can benefit consumers and that advertising bans, by increasing consumer search costs, can result in higher prices. Empirical studies have shown, for example, that prices for professional goods and services are lower where advertising exists than where it is restricted or prohibited by law.[48]

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[48] Improving Consumer Access to Legal Services: The Case for Removing Restrictions on Truthful Advertising (Federal Trade Commission,

Further, payment of referral fees may also provide lenders access to certain geographic markets that they otherwise might not have entered. A lender in California, for instance, may find it too costly to appeal to consumers in New York via mass media advertising or other means. Paying referral fees to an agent in New York may be a low-cost substitute for direct advertising; by doing so, the lender may be able to encourage New York agents to inform consumers of its rates.[49] In addition, a New York agent, who might not have otherwise adopted the computerized loan service, may now have an additional incentive to do so. These services often allow individuals to apply for the loan of a consumer's choice through the computer. Since consumers may be unlikely to favor an out-of-town lender without the convenience of this service (and agents receive fees from a lender only if the borrower chooses that lender), referral fees may provide the agent with an incentive to adopt this technology. Referral fees, by facilitating entry and increasing the amount of information on loan rates that agents possess, may increase the range of financing opportunities available to consumers. Discouraging this method of disseminating information could harm consumers.

1984); Effects of Restrictions on Advertising and Commercial Practice in the Professions: The Case of Optometry (Federal Trade Commission, 1980); Benham and Benham, Regulating Through the Professions: A Perspective on Information Control, 18 Journal of Law and Economics 421 (1975); Benham, The Effects of Advertising on the Price of Eyeglasses, 15 Journal of Law and Economics 337 (1972).

[49] Both advertising and referral fees are costs that must be passed on to consumers, but as the studies discussed in the previous footnote demonstrate, these costs are more than offset by the benefits of the increased competition that results from advertising. The costs of referral fees may be lower than the costs of direct advertising, while achieving equal or superior results. For example, referral fees are only paid when an agent recommends a lender; advertising, by contrast, blankets all potential customers, and so could be more costly.

Referral fees may provide agents with an incentive to recommend low-cost lenders. A lender with lower costs[50] (hence larger price-cost margins) than its rivals can induce an agent to recommend its loans. Such lenders could use part of their higher margin to pay an agent a larger bonus or commission, and remit some or all of the remaining margin to the borrower in the form of more attractive credit terms. This arrangement increases the likelihood that a recommendation will be made that benefits the borrower, while preserving the benefits of professional search.

2. Potential Harm From the Payment of Referral Fees

Previously, we discussed the general circumstances under which relationships between related intermediaries and producers could harm consumers.[51] When it is difficult for consumers to evaluate the attributes of a product or service before (or even after) it is purchased, and when it is costly to hire an independent source of expertise to assist in the purchasing decision, then opportunities for fraud may arise even in competitive markets.

To what extent are mortgage loans characterized by these properties? Although the difference is one of degree, not of kind, it would seem that mortgage loans are dissimilar from the types of services (e.g., car repair) that may be most amenable to fraud. Although mortgage contracts may be more complicated than other types of credit agreements, there nonetheless exists a set of observable criteria (e.g., interest rates, points, term of mortgage, etc.) to facilitate comparisons.[52] Consumer evaluations are facilitated by the affirmative disclosure requirements contained in regulations such as the Truth in Lending Act, which compels the disclosure of information about credit terms and costs.[53] This is not to say that information is so readily available that consumers cannot benefit from the services of an informed and competent agent; what it does suggest is that the information available to consumers may be sufficient to place constraints on the ability of lenders and brokers to take advantage of consumers.

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[50] Lenders' costs may differ for a variety of reasons. For example, some lenders may be more proficient at evaluating creditworthiness than others.

[51] See Section IV, pp. 12-14.

Arrangements that are economically equivalent to referral fees exist in this, as well as other industries. Earlier we described how many home builders and real estate agencies have diversified into consumer finance, thus offering consumers a potentially valuable financing option. Automobile dealers have for years offered similar types of services. These arrangements generate consumer benefits with no apparent adverse consequences. One of the differences between these sorts of arrangements and that in which lenders pay real estate brokers referral fees pertains to the lack of disclosure of the referral fees paid to the brokers. In the home builder and automobile dealer examples, the existence of the arrangement between the service provider and its financing arm is self-evident. Similarly, if lenders are allowed to pay referral fees to neutral intermediaries, the existence of a relationship between the lender and intermediary ought to be apparent.

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[52] At minimum, consumers can compare the referred lender's rates to rates of other lenders in the area by consulting the real estate section of the local paper. Information on the terms and conditions for a large number of loans appears to be available in newspapers across the country. An informal phone survey revealed that the Washington Post, Arkansas Gazette, Boston Globe, Los Angeles Times, Detroit Free Press, Cleveland Plain Dealer, Tampa Tribune, and Denver Post, for example, contain such information. Only one paper out of those contacted in the survey, the Des Moines Register, indicated that it did not publish information on mortgage loan rates.

[53] Regulation Z (Truth in Lending) 12 CFR § 226.

We have suggested, however, that HUD consider expanding its proposed lender exemption to include interested intermediaries, such as real estate agents. In most cases, if there are sufficient reasons to believe that referral fees are appropriate when paid to certain persons (e.g., neutral intermediaries), then it is not clear why it is not also appropriate to permit the payment of referral fees to real estate agents. If it appears that the expected benefits of lender payments are likely to exceed the corresponding costs, it would seem reasonable to permit these payments without placing restrictions on who may receive them.

In the case of lender referral fees paid to real estate agents, however the arrangement between the lender and agent may not be apparent. If the only difference between interested and neutral party referral fee arrangements is the consumer's knowledge that a payment is being made, then the appropriate policy measure may consist-of a mandatory disclosure requirement at the time of the referral for interested parties.

C. The Costs and Benefits of Mandatory Disclosure

A disclosure requirement could only be warranted if the fact to be disclosed would not be apparent absent the forced disclosure. If HUD limits its lender exemption to neutral intermediaries, there would be no need for a disclosure requirement. If, however, HUD expands its lender exemption to allow referral fees to interested intermediaries, HUD may wish to consider a disclosure requirement applicable solely to these intermediaries.

Disclosure would inform consumers that referring parties have incentives to recommend a particular lender. Since consumers retain the option of choosing another lender when referral fees are used, disclosure is likely to allow consumers to enjoy the benefits of referral fees while insuring that they are informed about intermediaries' incentives, and mitigating the types of concerns discussed above. Accordingly, disclosure is likely to be preferable to a prohibition of referral fees.

Disclosure may induce consumers to search for a loan package against which they can compare the terms offered by the referred lender. If, as we discussed earlier, referral fees provide brokers and agents incentives to recommend appropriate loan packages to the borrower, the benefit of disclosures may be small. If, however, the fees sometimes lead brokers to recommend lenders whose packages would not serve the consumer's best interest, then disclosure may induce the consumer to obtain additional information on the loans of the referred lenders and loans offered by other lenders. This additional information may result in the consumer seeking a more favorable loan package. Thus, if policy makers conclude that the potential for harm caused by referral fees is present, then disclosure at the time of referral might significantly reduce or eliminate these potential costs.

In weighing the desirability of disclosure, however, it is necessary to compare the benefits of disclosure to its costs. The potential costs are twofold. First, there is the obvious direct cost of simply conveying the information. Second, there is the potential "chilling" effect on the use of referral fees caused by the stigma that may attach to disclosure. Compulsory disclosure may suggest that accepting (or paying) referral fees is somehow improper, which would discourage the practice. Consumers may be induced to engage in unproductive search because of a mistaken belief that a better loan package is available.

The timing and form of disclosure is also important. Disclosure should be made early enough in the loan application process so that consumers can consider other loans. If the information is disclosed the day before the loan is to be signed, for example, it is likely to be too late for consumers to search for an alternative source of credit. Also, disclosure via a written form is likely to ensure that consumers actually are put on notice of the possible incentives facing the real estate agent recommending particular lenders.

VI. Concluding Remarks

Allowing the payment of referral fees may benefit consumers significantly. Benefits may include lower search costs, increased information, the increased use of innovative technologies, and lower prices for loan packages. Some of these benefits may be foregone if HUD adopts only the mortgage broker exemption. Real estate agents and other intermediaries may be less inclined to offer potentially valuable services if referral fees are proscribed.

HUD may wish to determine whether the characteristics of mortgage markets are such that referral fees pose a significant risk of harm. As discussed above, we do not believe that these markets are likely to produce adverse effects for consumers if referral fees are allowed. If HUD decides that referral fees generate both benefits and significant costs, however, it may wish to consider whether alternatives to a referral fee ban, such as mandatory disclosure of a referral arrangement between lenders and interested intermediaries, would eliminate these costs while preserving the benefits.

ATTACHMENT 3

EXAMPLES OF CONFUSING HUD GUIDANCE AND PROPOSALS

1. **HUD Has Never Adopted Regulations Implementing The 1983 Controlled Business Amendments To RESPA.**

2. **HUD's Proposed May 1988 Regulation Posed Numerous Problems.**

   a. **Disclosure** -- They set forth highly impractical disclosure requirements that, among other things, would have prohibited referrals and promotion of ancillary services from being made by telephone hotlines, electronic mail and other new technologies.

   b. **Required Use** -- They adopted a "required use" interpretation that suggested that programs which offered discounts to consumers who purchased multiple real estate services might violate RESPA even though a consumer could still purchase each service separately and at prevailing prices.

   c. **Consumer Rebates** -- They failed to codify HUD's long-standing, informal interpretation that rebates paid to consumers did not violate RESPA.

   d. **Referrals** -- They defined the term "referral" so broadly that the placement of television ads, magazine ads, the making of speeches and other forms of mass communication likely would have been referrals and violated RESPA.

   e. **Controlled Business Arrangements** -- They failed to adequately define and illustrate controlled business arrangements and, in particular, "the persons in a position to refer settlement services."

3. **HUD's Interpretations Elevate Form Over Substance.**

   HUD has illogically interpreted RESPA so as to prohibit certain arrangements between a parent and a wholly-owned subsidiary or two wholly-owned subsidiaries of a common parent, but permits it when undertaken by two divisions of a company. Such an interpretation is not only illogical on its face but contradicts the United States Supreme Court's teaching in Copperweld Corp. v. Independent Tube Corp., 467 U.S. 752 (1984) that the coordinated activity of a parent and its wholly-owned subsidiary is the conduct of a single actor in the same way that the operations of a corporate enterprise organized into divisions must be judged as the conduct of a single actor. In fact, a wholly owned subsidiary's performance is entirely dictated by its parent sole shareholder. Although HUD has repeatedly stated that it is necessary to have two distinct actors to violate Section 8 of RESPA, HUD has refused to apply Copperweld to Section 8 and instead permits the legality of particular arrangements to be governed by the form, rather than substance, of the transaction.

4. **HUD's Various Interpretations Of The Employer/Employee Exception Are Confusing And Irreconcilable.**

HUD has correctly stated that fees paid between employers and employees are not subject to Section 8 since an employer acts through its employees and are functionally the same entity. Nevertheless, it has inconsistently interpreted this principle. For example, in some opinion letters, HUD has correctly permitted companies or their subsidiaries to pay employees of their subsidiaries for the referral of settlement services to other subsidiaries, recognizing that the persons receiving compensation, while technically employed by a particular subsidiary, are functionally the employees of the parent companies. However, in other letters HUD incorrectly concluded that companies could not compensate employees or employees of subsidiaries for the referral of settlement services to other subsidiaries because it was not the scope of employment of such employees.

5. **HUD's Interpretations Regard The Lowering Of Settlement Costs As Irrelevant.**

Although RESPA was enacted in order to reduce settlement costs, HUD opinion letters frequently state that the fact that a particular program will not raise, or even decrease, settlement costs is not relevant to a determination of whether it complies with Section 8's requirements.

6. **HUD's Opinions On Purchasing Customer Lists And Real Estate Prospects Are Inconsistent.**

Although HUD has stated that the purchase or sale of customer lists by settlement service providers in the ordinary course of business does not involve the payment of a fee in violation of RESPA, HUD has suggested that efforts by real estate brokers to compensate individuals or employees of affiliated organizations who provide them with prospects for them to solicit would violate RESPA. This latter interpretation is particularly illogical since

Section 8 of RESPA requires a settlement service to involve a federally related mortgage loan and at the time a prospect who may want to purchase or sell residential real estate is identified, there is obviously no involvement of a federally related mortgage loan. Indeed, one cannot tell whether the prospect would even buy or sell a house, much less finance it with a federally related mortage as opposed to paying or receiving cash or using an assumed loan, a wrap-around mortgage, an installment land sale contract or other non-federally related financing methods.

ATTACHMENT 6

REAL ESTATE SETTLEMENT PROCEDURES ACT (RESPA)

Coldwell Banker urges Congress and the Department of Housing and Urban Development to ensure that RESPA is not interpreted or amended in a manner which will reduce competition and eliminate freedom of choice for the consumer with respect to the provision of mortgages and real estate services. In particular, Congress and HUD should ensure that a real estate broker/salesperson ("broker") or other real estate service provider can receive compensation from a lender or borrower for the value of mortgage services provided.

I. THE ISSUE IS NOT REFERRAL FEES

Coldwell Banker agrees that fees paid by lenders to brokers for the simple referral of business are illegal and that abuses should be curtailed. Section 8 of RESPA already flatly prohibits the payment or receipt of referral fees. The issue, therefore, is whether real estate brokers should be singled out among all other real estate service providers and be prohibited from being compensated for the fair value of mortgage services they provide lenders or consumers.

II. REAL ESTATE BROKERS SHOULD BE PERMITTED TO RECEIVE THE FAIR VALUE OF MORTGAGE COUNSELING AND ORIGINATION SERVICES THAT THEY PROVIDE

In today's changing real estate marketplace, in which the number of mortgage products has expanded and leisure time has been shortened, borrowers have sought convenience in selecting mortgage loans and real estate related services. Real estate brokers are ideally situated to provide borrowers and consumers with services in these areas. For example, real estate brokers have expended substantial resources in requiring and learning sophisticated computer hardware and software that can provide comparative mortgage information, prequalify borrowers, select a suitable mortgage and process mortgage loan applications. Brokers have also invested in training and updating their employees about the latest developments in mortgage products and origination procedures. Naturally, these investments have not been without cost and consequently real estate brokers have charged fees to both lenders and home buyers for the value of the mortgage services they furnish.

If brokers are prevented from being compensated for the value of these services, they will stop providing them, which will decrease consumer choice and competition and ultimately increase consumer costs.

1. Allowing Compensation To Real Estate Brokers For Mortgage Services Will Increase Consumer Choice And Competition

Many mortgage lenders find they can enter new markets by providing real estate brokers with computerized loan origination systems that not only display their loan products and rates but also prequalify and process loans for the broker's customers. These are often placed in real estate offices in less populated markets that would otherwise be too costly for a mortgage lender to enter by establishing branch offices. Allowing real estate brokers to offer mortgages on behalf of these lenders — in addition to mortgage services they offer on behalf of lenders already in that market — increases competition in the market and the choice of mortgage products for mortgage customers.

2. Allowing Compensation To Real Estate Brokers Will Ultimately Decrease Consumer Costs For Mortgage Services

Lenders that use real estate brokers to prequalify, originate and process mortgage loans through computerized origination systems or other related systems are using the broker to provide services that otherwise would be provided by the lender's own employees, usually loan officers. Employing brokers in this fashion allows the lender to approve loans more efficiently. Real estate brokers have excellent access to borrowers and to the information needed to process and originate loans. Most lenders who use real estate brokers in this fashion find that their origination costs decrease, thereby permitting a reduction in the charges to consumers.

III. MBA'S ARGUMENTS AGAINST REAL ESTATE BROKERS RECEIVING COMPENSATION FOR MORTGAGE SERVICES ARE UNFOUNDED

In an attempt to protect its members from increased competition from real estate brokers and other mortgage lenders, MBA has urged that HUD interpret RESPA or that Congress amend RESPA to prohibit a real estate broker who receives a fee from the underlying real estate transaction from receiving compensation from a lender or borrower for providing mortgage services. The MBA attempts to support its proposal by arguing that these activities create (1) a conflict of interest, (2) adverse steering; and (3) quality control problems. MBA's arguments are unfounded and are merely an attempt to protect the turf of its members.

1. Real Estate Brokers' Counseling Of Borrowers Assists Sellers And Does Not Create A Conflict Of Interest

No conflict of interest exists when a real estate broker who receives a commission from the seller for the sale of a house assists a buyer/borrower in obtaining home financing. The buyer and seller have already agreed on the purchase of a house at specific price. The real estate broker, therefore, is advising the buyer/borrower about an entirely different matter (mortgage finance) than the broker advised the seller (maximizing the resale price of the seller's home). In fact, the home seller wants the real estate broker to assist prospective buyer/borrowers about their financing options so that buyers can complete the sale. Moreover, Coldwell Banker recommends and believes it is the practice of most real estate brokers to sign written agreements with the seller and with the borrower that disclose the real estate broker's relationship with each party and the broker's responsibilities to each. Such disclosure eliminates any theoretical conflict of interest that could exist by providing the buyer with full knowledge of the broker's involvement with, and compensation by, the seller. Given the convenience and resources that the broker brings to the mortgage origination process, this approach is far more sensible and efficient than prohibiting the real estate broker from counseling home buyer/borrowers on real estate financing.

2. Permitting Real Estate Brokers To Be Fairly Compensated Does Not Encourage Adverse Steering

Many consumers consult real estate brokers about mortgage loan options because the brokers have expertise about a number of different mortgage programs or possess computerized loan information systems to evaluate others. So long as brokers disclose any relationship they have in a mortgage lender they recommend, no adverse steering can result. Similarly, the broker's disclosure, prior to a referral of any compensation he may earn from a lender, will eliminate adverse steering. Moreover, real estate brokers, as professionals, are in business to sell homes. Assisting the borrower to obtain financing is only one of several services they provide to consummate that sale. Success in the real estate brokerage business is dependent on satisfied customers and the recommendations of an extensive network of real estate professionals. Sacrificing a borrower's interest in order to earn a fee from a lender is counterproductive since it is likely to irrevocably damage a broker's most important asset — his or her (their) reputation with peers, customers and clients.

3. Permitting Real Estate Brokers To Be Fairly Compensated Does Not Lead to Quality Control Problems

Real estate brokers, who counsel consumers about mortgage alternatives, prequalify borrowers and process loans for lenders, receive the same, if not greater, training as other mortgage brokers or loan officers. The verification that lenders need to make based upon real estate broker-generated information is no different than the verification of information generated by a loan officer. Accordingly, the assertion that real estate broker participation in mortgage programs leads to quality control problems is unsupported by either fact or logic.

SUMMARY

Real estate brokers have come to play an important role in the mortgage origination process and the provision of related services. Real estate brokers offer the latest in electronic mortgage systems and provide consumers with the expertise, information and convenience they demand. As the FTC has observed, providing consumers with greater information and expertise, like other forms of advertising and information dissemination, actually lowers, not raises, prices for professional goods and services. Accordingly, Congress and HUD must act by placing the interests of consumers first. Permitting real estate brokers to be fairly compensated for mortgage brokerage services will ensure that such services continue to be offered, thereby increasing competition and consumer choice, and ultimately lowering origination costs and mortgage prices. The arguments to the contrary made by MBA are merely an attempt to protect the turf of its members and to eliminate real estate brokers as competitors. Such arguments are unpersuasive and should be rejected.

JOHN H. CHAFEE
RHODE ISLAND

CHAIRMAN, REPUBLICAN
CONFERENCE

COMMITTEE ON FINANCE

RANKING MEMBER, COMMITTEE ON
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September 17, 1990

The Honorable Alfonse M. D'Amato
United States Senate
Washington, D.C. 20510

Dear Al:

Thank you for scheduling a hearing in the Subcommittee on Housing and Urban Affairs on the implementation of the Real Estate Settlement Procedures Act (RESPA). I appreciate your interest in this important matter.

In March of this year I joined with four other Senators in writing to Senator Riegle, the Chairman of the Banking Committee, to suggest that hearings be held to address the uncertainty surrounding the issue of referral fees. As you know, one of the purposes of RESPA was to prohibit the payment of fees by lending institutions to real estate agents for the referral of mortgage loan applications. In recent years, however, the Department of Housing and Urban Development has issued a number of position papers that seem to allow payment of referral fees.

HUD's current interpretation of RESPA raises a number of concerns for both consumers and lenders. Since 1974, RESPA has protected consumers from excessive costs associated with buying a home. Homebuyers still need that protection today. At the same time, recent technological developments in the financial services industry have brought mortgage origination services into the modern age. I hope that this week's hearing will help both parties better understand the intent of RESPA and the implications of HUD's current treatment of the matter.

Again, I appreciate your willingness to examine this timely issue.

Sincerely,

John H. Chafee
United States Senator

JHC/rkb

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Donald A. Maiolatesi
Executive Vice President

October 1, 1990

Mr. Edward M. Malan
Senate Committee on Banking, Housing,
& Urban Affairs
Room SD 534, Dirksen Senate Office
Building
Washington, D.C. 20510

RE: Roundtable Hearing on Real
Estate Settlement Procedures
Act (RESPA) of Wednesday,
September 19, 1990

Dear Mr. Malan:

I sincerely appreciate the opportunity to send in my written comments because of our testimony having to be cut short. My comments will be on the widespread violation of one of the pure and initial intents of the Real Estate Settlement Procedures Act (RESPA) of 1974: elimination of kickbacks or referral fees that tend to increase unnecessarily the costs of certain settlement services.

Having been in mortgage banking for 20 years, I witnessed first hand the pre-RESPA days where kickback was an everyday way of life. Kick back that especially preyed on the first time home buyer.

In those days, without RESPA, competitive pricing, good service and reputation were all immaterial. What mattered was: "How much can I get if I refer the buyer to you?" The consumer paid dearly. Accordingly, congress initiated RESPA that resulted in total elimination of this wrongful practice. RESPA essentially put lending back on the free enterprise and competitive basis that it always should have been. Unfortunately, it lasted less than ten years.

In the early 1980's, a sixth circuit court ruling in Detroit, Michigan concluded that the making of a mortgage loan was not part of the settlement service. This action, along with informal opinions issued by the Department of Housing & Urban Development reopened the flood gates to allow "legal" kickbacks.

The court ruling gave some lenders the freedom to return to the days of kickback. HUD's informal opinions opened cracks for lenders to find comfort in returning to origination methods by directing extra commissions or fees to people who already had a financial interest in the real estate transaction. The result was identical to the pre-RESPA days: extra fees in the transaction passed on to the uneducated consumer.

Please allow me to discuss a few points so you may understand both sides of this issue:

(1) What I am against is the illegal aspect of kickback and preying on the unsuspecting. I am not arguing in an attempt to eliminate the competition.

(2) The entire issue is not solely that of Citicorp and its many imitators. The kickback issue is also dynamically large in small lenders and small real estate companies across Michigan and this country where kickback fees are used to refer business for little or no work performed. In addition, lenders are refused access to those real estate offices where referrals are paid, thereby indirectly denying the home purchaser the ability to make a choice.

(3) Some lenders feel they comply with the law by defining their fee as representing an amount equal to services performed. Accordingly, recipients of the fee, who are also receiving another fee in the transaction, justify the kickback by performing a small or nearly insignificant service.

The result is truly the same. You have a conflict of interest with receiving more than one fee when representing both parties in a transaction; and the work performed is significant, and at best a very little value because qualifying/interviewing the buyer is directly related to as commission paid at the closing of the sale.

(4) Computerized Loan Origination programs (CLO's) in and of themselves alone are not a reason to charge extra fees to the consumer. Many CLO's are used to disseminate rates and fees, on electronic "rate sheets". That, along with inputting a few cursory items is, again, not a reason to charge more fees.

(5) Quality is an extremely large issue. Our industry has quality control systems to comply with not only the numerous federal and state guidelines/act but also right and wrong. I sincerely question how anyone receiving another fee in the transaction can remain impartial and thorough when interviewing a home buyer to qualify for a mortgage.

Violations continue, specifically in section 8 of RESPA, primarily because HUD has not exercised the law against violators. The message being sent is: If no one is caught, it must be okay.

I sincerely appreciate the opportunity to discuss my side of the issue.

Sincerely,

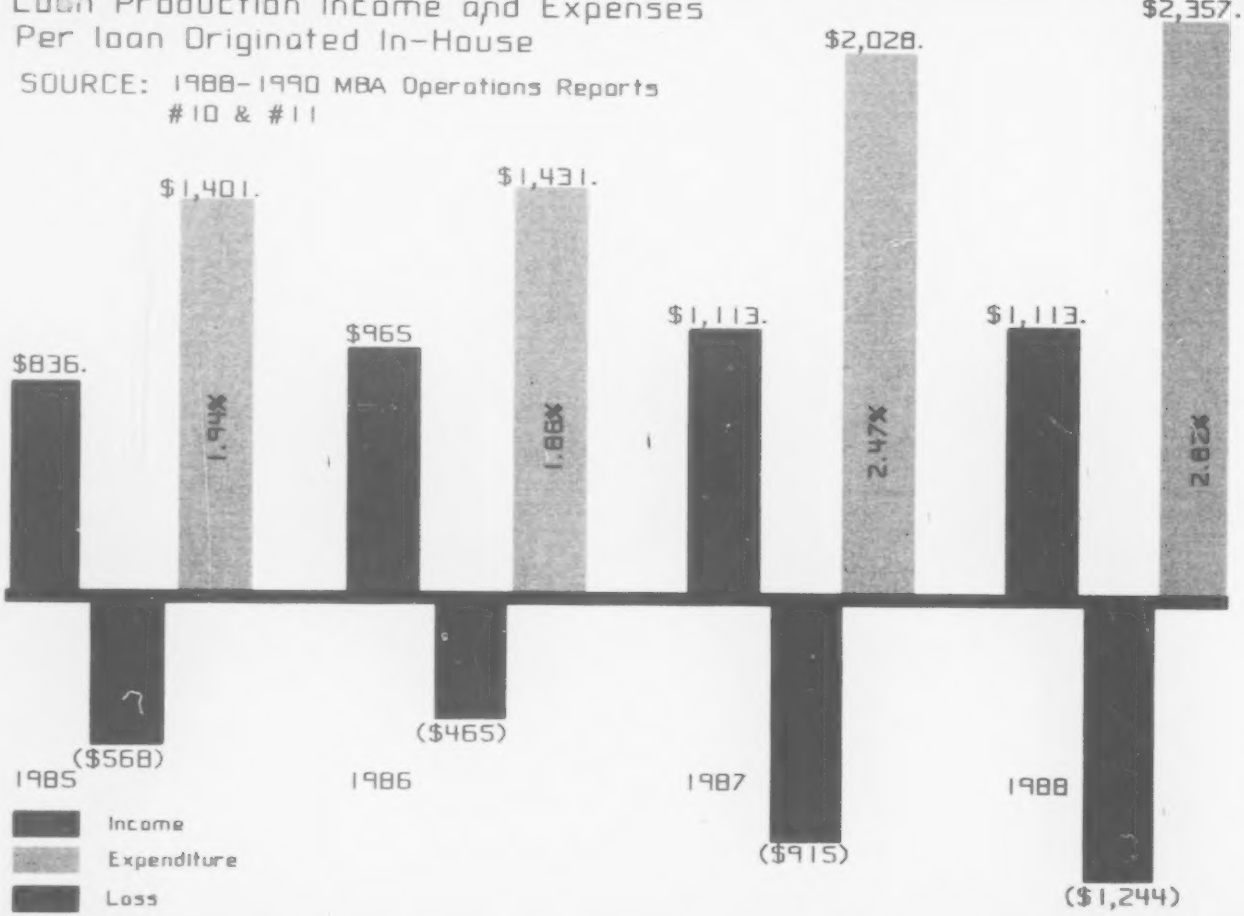
Donald A. Maiolatesi

Donald A. Maiolatesi
Executive Vice President

DAM/dlv

Loan Production Income and Expenses Per loan Originated In-House

SOURCE: 1988-1990 MBA Operations Reports #10 & #11



EX. B